S. HRG. 99-332

ENCOURAGEMENT OF COGENERATION ACTIVITIES BY GAS UTILITY HOLDING COMPANY SYSTEMS

HEARING

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 727

TO CLARIFY THE APPLICATION OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 TO ENCOURAGE COGENERATION ACTIVITIES BY GAS UTILITY HOLDING COMPANY SYSTEMS

SEPTEMBER 17, 1985

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ENCOURAGEMENT OF COGENERATION ACTIVITIES BY GAS UTILITY HOLDING COMPANY SYSTEMS

TUESDAY, SEPTEMBER 17, 1985

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON SECURITIES,
Washington, DC.

The subcommittee met at 4 p.m., in room SD-538, Dirksen Senate Office Building, Senator John Heinz presiding.

Present: Senators Heinz, D'Amato, Hecht, and Cranston.

Also present: Representative Doug Walgren.

OPENING REMARKS OF SENATOR HEINZ

Senator HEINZ. Ladies and gentlemen, the Subcommittee on Securities will come to order. We are here today to discuss S. 727, legislation that I introduced and was cosponsored by Senator Specter. This bill was introduced on March 20 of this year and is designed to clarify the application of the Public Utility Holding Company Act of 1935 [PUHCA] to allow three natural gas holding companies—Consolidated Natural Gas, National Fuel, and Columbia Natural Gas—to participate in cogeneration activities, consistent with the policies espoused by the Public Utilities Regulatory Policies Act of 1978.

I have an opening statement I am going to put in the record in its entirety. I just want to make two comments. The first is that it turns out all three of these companies have operations in Pennsylvania and throughout the Ohio Valley, which is an intensive base for energy and a great use of cogeneration technology. It would substantially reduce industrial energy costs and thereby prevent plant closings, retain jobs, and help the areas in the district fight foreign competition.

Second, I want to observe that S. 727 is fully consistent with policies Congress sought to foster by passing the Public Utility Regulatory Policies Act of 1978. Indeed, the passage of S. 727, I believe, furthers the goals of that 1978 law and will amend the Public Utility Holding Company Act of 1935 by making that act consistent with more recent statements of congressional intent. The amendment does not in any way obstruct the policies which the 1935 act was designed to foster.

[The complete prepared statement follows:]

STATEMENT OF SENATOR HEINZ

Mr. Chairman, we are here today to discuss S. 727, legislation which Senators Specter, Moynihan, Riegle, and I introduced on March 20 of this year. Put simply, S. 727 is designed to clarify the Public Utility Holding Company Act of 1935 [PUHCA] to allow three natural gas utility holding companies—Consolidated Natural Gas, National Fuel, and Columbia Natural Gas to participate in cogeneration activities consistent with the policies espoused by the Public Utility Regulatory Policies Act of 1978 [PURPA].

Before I go on and explain S. 727 in a little more depth, I want to take this opportunity to thank Senator D'Amato, our distinguished chairman for scheduling this hearing. From all indications, S. 727 is a noncontroversial bill, but it deals with an area of law which can be very confusing and with which many of us have little familiarity. Because of that, I felt it was important to have a hearing and thus clear up any questions that anyone might have about what it is we are trying to accomplish with S. 727 and to ensure that any problems we might have overlooked are brought to light. I am most grateful to our distinguished chairman for ensuring that we have this opportunity to examine S. 727 on the record.

This legislation is a simple, noncontroversial bill which will enable the previously mentioned gas utility holding companies to participate in cogeneration. In 1978, Congress passed the Public Utility Regulatory Policies Act in response to energy problems brought on by the oil price shocks of the 1970's. The incentives for cogeneration in PURPA were directed to all businesses so as to ensure the widest possible implementation of this plan to utilize fully domestic energy resources.

Unbeknownst to Congress when it passed PURPA was the fact that only three companies in the entire Nation would be inadvertently excluded from participating in cogeneration projects. These three companies are the only natural gas companies registered under the Public Utility Holding Company Act of 1935. This oversight is particularly unfortunate because these companies, with their expertise in energy matters and in thermal technology, so important to cogeneration, are particularly qualified to participate in cogeneration ventures. All three have operations in Pennsylvania and throughout the Ohio Valley region.

This legislation is needed because Pennsylvania, like most of the Ohio Valley, has an energy-intensive base of industry. It is well demonstrated elsewhere that cogeneration can substantially reduce industrial energy costs. A DOE-sponsored study calculates that cogeneration would produce 15 to 18 percent energy savings for the five major energy-consuming industries. Another DOE-sponsored study indicates a potential cogeneration capacity of over 40,000 megawatts for the United States. This is the equivalent of about 100 average size central station powerplants. Of this national potential, over 7 percent is in Pennsylvania.

Cogeneration reduces an industrial plant's costs by lowering the cost of needed steam through more efficient energy use. These savings occur because cogeneration makes byproduct electricity either from formerly wasted heat or through far more efficient fuel use than possible at central powerplants. This secondary electricity is

usually sold to the local electric utility but can be used directly by the industrial customer. The resultant cogeneration benefits are passed to the industrial customer from third-party cogenerators through various mechanism such as shared fuel savings or steam price markdowns.

These savings can be significant. For example, over the life of a modest-sized cogeneration facility the industrial customer can save tens of millions of dollars. In addition, residential and commercial gas utility customers benefit indirectly from gas-fired cogeneration because the basic fixed costs of the utility would be spread over higher gas volumes. Electric consumers can also benefit by avoiding increased bills due to costly new generating plants. Moreover, such cogeneration facilities are environmentally sound and would use state-of-the-art pollution control technology.

These benefits and savings are important in maintaining the health of local and State economies. Current Pennsylvania employment rests on a manufacturing keystone of 1.1 million jobs, of which some 300,000 are in energy-intensive industries. Over 126,000 are in steel alone. Six large steel mills and additional smaller ones have closed in this region over the last 4 years. Just one cogeneration facility sited at a steel industry plant could help protect 3,000 or more jobs. Such a facility would also provide $100 million in direct and indirect payrolls during contruction.

This industrial base of energy-intensive jobs in Pennsylvania supports an additional infrastructure of hundreds of thousands of additional jobs. In addition to the spinoff from improved industrial vitality, cogeneration can benefit this infrastructure directly. For example, cogeneration can help control the rising cost of medical care by lowering the operating costs of hospitals which are large energy consumers.

Cogeneration is clearly taking hold in regions other than Pennsylvania and the Ohio Valley. There are dozens of cogeneration projects underway in California and on the gulf coast. Unfortunately, this is not the case in the machine shop of America where we also find it increasingly difficult to compete with growing foreign competition. There have been more than 100 plant closings in this region over the past 4 years. Cogeneration offers heavy industry a chance to become more competitive by reducing production costs. Energy accounts for 30 percent of the materials cost of producing steel. It is also an important part of the cost of production in the glass, paper, cement, chemical, and many other industries.

Why, then, have these industries not taken the lead in developing their cogeneration potential? The answer is because cogeneration requires a large capital investment. A cogeneration plant may cost $25 million in comparison with $1.2 million for a regular steam boiler without cogeneration. Thus, do-it-yourself cogeneration by industry carries a large capital investment with it. While our energy-intensive industries are obviously anxious to reduce their high energy costs, their first order of investment must logically be in their higher payout of functionally related core business—such as the improvement or modernization of aging plants and production lines.

Not only is the involvement of the three registered gas utilities badly needed, it is also eminently logical. Cogeneration is a natural

outgrowth of the gas industry's thermal knowledge and historic service to its industrial customers. This stems from abundant gas industry knowledge of the industrial customer based upon industrial application consulting, energy audits, and the like. Also, many cogeneration facilities would use natural gas engines or turbines which are routine in gas pipeline operations.

The thermal knowledge and experience of the gas industry is equally applicable and valuable irrespective of whether the fuel source is natural gas, oil, or coal. Such site-specific understanding of industrial thermal needs is typically not available from an electric utility. Yet, ironically, the three registered gas utility holding companies are barred from any cogeneration ownership whatsover in contrast to the registered electric utility holding companies. More importantly, none of the Ohio Valley electric utilities have shown any interest in owning and operating cogeneration plants.

Most of the gas utilities serving such regions as the Ohio Valley are not large enough financially to take on the major cogeneration plants needed by heavy industry, other than the three gas utility systems which are the only companies barred from doing so. Moreover, in many instances, these other utilities also lack the specialized personnel and experience which are required for third-party ownership and operations.

In contrast, the registered gas companies have the financial resources and the expertise to establish cogeneration in the Ohio Valley and elsewhere. Their participation will enlive competition for cogeneration projects to the economic benefit of such regions.

S. 727 does not amend PURPA; not does it tamper with any of the board conceptual issues and safeguards inbedded in PURPA and PUHCA. Apparently, the SEC does not object in principle to the ownership and operation of cogeneration facilities by the three registered gas utility holding companies. The concern of the SEC is based strictly on legal interpretation; not policy. The SEC's Division of Corporate Regulation, while favoring the involvement of registered gas utilities in cogeneration, cannot technically square the functional relationship between cogeneration and gas utility operations.

S. 727 provides simply that, notwithstanding any functional relationship limitations in PUHCA, section 11(b)(1), these three companies will be permitted to participate in cogeneration activities. However, they will only be permitted to invest in, acquire or retain "qualifying cogeneration facilities" as defined in or pursuant to PURPA. Finally, in a clarification of technical importance, the proposed bill affirms that registered gas companies are entitled to the benefits and subject to the restrictions of any exemption relating to PUHCA granted by the Federal Energy Regulatory Commission pursuant to its authority under PURPA. Such affirmation is a housekeeping measure to ensure that the purpose of this bill in allowing the three registered gas holding companies to participate fully in cogeneration is not inadvertently frustrated.

This proposed bill does not affect the applicability of any section of PUHCA other than section 11(b)(1) and then only to the extent of permitting cogeneration ownership. Thus, the three registered gas companies, once participating in cogeneration, will still be required under PUHCA to obtain the SEC's permission for financing

each project and will still remain subject to all of the other PUHCA restrictions. Most importantly, the SEC will retain the power to forbid or terminate the involvement of any of the three companies in any cogenerating project which might appear to jeopardize its public utility functions.

In light of the above, I hope that this committee and the Senate will act promptly to correct the inadvertent oversight which forbids cogeneration to only three companies in the entire Nation. Even after this legislation is enacted, these companies will still be subject to all of the SEC's comprehensive reporting and accounting procedures, thereby keeping intact all of the existing congressional and SEC safeguards. This legislation would not only encourage needed development of Ohio Valley cogeneration; it would also provide for cogeneration project competition which will be to the benefit of all cogeneration and utility customers.

Thank you, Mr. Chairman, I look forward to the testimony of our distinguished witnesses.

[Copy of proposed bill, with explanation of provisions of S. 727, follow:]

II

99TH CONGRESS
1ST SESSION

S. 727

To clarify the application of the Public Utility Holding Company Act of 1935 to encourage cogeneration activities by gas utility holding company systems.

IN THE SENATE OF THE UNITED STATES

MARCH 20 (legislative day, FEBRUARY 18), 1985

Mr. HEINZ (for himself, Mr. SPECTER, Mr. MOYNIHAN, and Mr. RIEGLE) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To clarify the application of the Public Utility Holding Company Act of 1935 to encourage cogeneration activities by gas utility holding company systems.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, notwithstanding section 11(b)(1) of the Public Utility Holding Company Act of 1935, a company registered under said Act solely by reason of direct or indirect ownership of voting securities of one or more gas utility companies, or any subsidiary company of such registered company, may acquire or retain, in any geographic area, any interest in any qualifying cogeneration facilities as defined pursuant to the Public

Utility Regulatory Policies Act of 1978, and shall qualify for any exemption relating to the Public Utility Holding Company Act prescribed pursuant to section 210(e) of the Public Utility Regulatory Policies Act. Nothing herein shall be construed to affect the applicability of provisions of the Public Utility Holding Company Act, other than section 11(b)(1), to the acquisition or retention of any such interest by any such company.

Appendix A

Explanation of Provisions of S.727

The proposed bill is free standing, not amending either PUHCA or PURPA.

Proposed Bill	Explanation
"That, notwithstanding Section 11(b)(1) of the Public Utility Holding Company Act of 1935,	Because of Section 11(b)(1), a public utility holding company may not acquire or retain any interest in a business which is not functionally related to its utility operations. The SEC, by applying a strict, technical interpretation of the Section 11(b)(1) test, failed to find such relationship between cogeneration and the operations of natural gas utilities.
a company registered under said Act solely by reason of direct or indirect ownership of voting securities of one or more gas utility companies, or any subsidiary company of such registered company,	This clause limits the application of the bill to the three remaining gas companies still registered under PUHCA. The modifier "solely" was inserted to make certain the bill would not apply to registered electric companies owning some gas facilities. Such companies are already permitted to participate in cogeneration under PUHCA.
may acquire or retain,	"Or invest in" was not included because this term is undefined and not commonly used in PUHCA. Rather, the term "acquire" is meant to embrace investments in qualifying cogeneration facilities by the registered gas companies, that is to say, with respect to permitting their involvement early on in the design and construction of such facilities.
in any geographic area,	Registered gas utility holding companies have traditionally engaged in utility and in non-utility activities. Utility activities are retail gas distribution operations in a local service territory. Non-utility activities such as gas exploration and production, or interstate pipeline operations have never been geographically restricted. Since cogenera-tion is clearly a non-utility activity, it also should be free of geographical restrictions. For obvious reasons, the three registered gas companies have a substantial incentive to direct most of their cogeneration efforts to customers within or near their utility service territories and other areas

where they have operations, such as gas production. They should be free to compete in developing cogeneration in these and any other areas, just as are all other gas companies.

any interest in any qualifying cogeneration facilities as defined pursuant to the Public Utility Regulatory Policies Act of 1978,

The bill has been written so that both the statutory and FERC's administrative definitions of "qualifying cogeneration facili-ties" are included. Such facilities are required to meet FERC-defined efficiency targets.

and shall qualify for any exemption relating to the Public Utility Holding Company Act prescribed pursuant to Section 210(e) of the Public Utility Regulatory Policies Act.

Though FERC has exempted qualifying cogeneration facilities from "electric utility" status under PUHCA, the SEC continues to view qualifying cogeneration facilities acquired by registered public utility holding companies as "electric utility companies" under PUHCA. Consequently, a registered gas holding company, acquiring a cogeneration facility (still an "electric utility" under PUHCA according to the SEC) might not, absent this legislation, meet the statutory standard of being an "integrated public utility system" as required by Section 10(c)(2) of PUHCA. This clause clarifies the Congressional intent to make cogeneration exemptions prescribed pursuant to PURPA and relating to PUHCA as available to registered gas holding companies as they are to all other gas companies. As a result, cogeneration acquisitions by registered gas holding companies will be viewed as nonutility acquisitions under PUHCA, thereby avoiding any possible utility integration problems.

The "any exemption" referred to in this clause means those PUHCA exemptions promulgated by the FERC which are in place and legally effective at the specific time any one of the three registered gas companies should attempt to acquire a qualifying cogeneration facility.

Qualifying the registered gas companies for the FERC exemption pursuant to PURPA eliminates any need to reference sections of PUHCA other than 11(b)(1) in the proposed bill. Otherwise, the proposed bill would have to assert that qualifying cogeneration facilities were not to be deemed "electric utility com-panies" as

described in Section 2(a)(3) or "utility assets" as described in Section 2(a)(18) of PUHCA. Clearly, the approach used in S.727 avoids the definitional com-plexities posed by PUHCA in a preferable manner.

Nothing herein shall be construed to affect the applicability of provisions of the Public Utility Holding Act, other than Section 11(b)(1), to the acquisition or retention of any such interest by any such company."

PUHCA remains unaffected except that Section 11(b)(1) is to be construed as permitting registered gas companies to acquire or retain cogeneration facilities.

Senator HEINZ. At this point, I'm pleased to welcome our first witness, a distinguished member of the House of Representatives, Congressman Doug Walgren of the 18th Congressional District in Pennsylvania, which, incidentally, makes him my Congressman.

Congressman Walgren, we're delighted to have you here. I will not ask the question we ought to ask of our Congressman, which is, What have you done for me lately? What you are doing here today is quite important, and I'm pleased to welcome you.

STATEMENT OF DOUG WALGREN, U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. WALGREN. Thank you very much, Senator. It is always striking to think of you as having preceded me in the representation of the communities of western Pennsylvania. There was a saying at one point when you were representing that district that you were the best Congressman that western Pennsylvania had ever had. And I would never dispute that characterization.

So we follow your career.

Senator HEINZ. Congressman, you're mighty kind, but you're getting me in trouble with all the other western Pennsylvania Congressmen.

Mr. WALGREN. As you know, I have introduced companion legislation in the House of Representatives, H.R. 1779, which enjoys broad bipartisan support and now has a total of 28 cosponsors from five States. I appreciate the opportunity to join in this hearing and to urge your colleagues to support Senate passage of your bill.

As you emphasize, this legislation is particularly important to Pennsylvania and the entire Ohio Valley. This has been a strange development where we look around and find only three public utility holding companies nationwide that are prohibited by an act that long preceded any real interest in cogeneration from joining in cogeneration.

Cogeneration has tremendous benefits for our society. It is one of the keys to limiting the waste in energy consumption that is so prevalent in our system; literally being able to piggyback two systems on one industrial need has the potential to multiply the energy output that is captured by 25-30 percent.

$700 MILLION SAVINGS IN INDUSTRIAL COSTS

And this, on a State-by-State basis, has tremendous revenue implications. It's estimated that Pennsylvania alone, if it were to fully use the cogeneration potential that is available, could save some $700 million in savings in industrial costs. And that's just Pennsylvania.

The other States in the Ohio Valley would participate on the same level. And it is ironic that a whole region of the country has been left out of cogeneration for no real reason that presently exists.

It is good energy policy to allow these public utility holding companies to join in the investments necessary to bring about cogeneration. There really is no reason to do anything else. Certainly, this was the intent of Congress whenever we considered cogeneration legislation. The reasons utility holding companies were originally prohibited from engaging in activities unrelated to the production and sale of natural gas simply don't apply here.

All the rest of the gas companies that are engaged in similar activities now are not prohibited from pursuing cogeneration in their areas. And there is no really good reason to prohibit these three registered gas companies from doing so.

It seems especially unfair and especially important legislation for the Northeast, in particular the Ohio Valley, because we, by and large, have had difficulty catching up with the rest of the Nation in the present economy.

As I understand it, nationwide, there has been a substantial job growth. In Pennsylvania, ours has increased something less than 2 percent as a whole, where the Nation has really leaped forward in substantially greater amounts.

This kind of legislation would stimulate exactly those areas of economic activity in which we have a broad base. This applies not only to the old basic industries which have the most to gain by this kind of cogeneration availability because they consume so much energy; but also, to the manufacturing facilities who could take advantage of supplying the equipment needs of cogeneration. The region's cogeneration development would call for the production of the very thing that industry in this band of our country is designed to produce. I think particularly of: Steam turbines, engine generators, boilers, switching gear, substations, instruments and controls, piping—the ability to stimulate this part of the economy would be a great help to this region that has had difficulty in following the rest of the Nation in the economy in the recent years.

Finally, I'd like to emphasize that this legislation, as you have addressed it, Mr. Chairman, is very narrowly focused. It's designed to be a rifle shot, to pick up only those areas that have been left out. The bill stands by itself. It does not raise the specter of amending the basic regulatory structure of the country, or of the public utility area. And it does not alter the Security and Exchange Commission's general regulatory jurisdiction over these companies.

It leaves all that framework that has been associated with consumer protection and the values that have been pursued by the original Regulatory Act of 1935 and the effort in 1978. It leaves all those values intact. It doesn't threaten any of them. So it should be

a noncontroversial piece of legislation and I hope that it can, because of its simplicity, move through the legislative process, both in the Senate and the House, without delay. There really is no reason it shouldn't.

And if we can be successful in that, I know the House would be ready to act immediately, and I'm sure the Senate is in the same position. There is no good reason why we can't deliver this piece of legislation to the President's desk for signature by the end of the year.

I know that's your intent. I really want to encourage you in that process and support you in any way I can.

[The complete prepared statement follows:]

STATEMENT OF

DOUG WALGREN, U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. Chairman:

I appreciate the opportunity to be here today to urge support of S. 727, a bill which would clarify that the Nation's three registered gas holding companies may participate in cogeneration activities. I have introduced companion legislation in the House (H.R. 1779), which enjoys broad bipartisan support and now has a total of twenty-eight cosponsors from five states.

Passage of this legislation is particularly important to the area which I represent and, as Senator Heinz has pointed out, to Pennsylvania and the entire Ohio Valley. There is simply no valid policy reason to prevent these three registered gas companies -- coincidentally, the three gas companies which serve the Ohio Valley -- from participating in cogeneration. This bill would merely clarify the intent of Congress on this issue, and would place these three companies on the same footing as every other gas company in the country, all of which currently can, and indeed are, developing cogeneration projects.

I want to emphasize to the Committee that Senator Heinz and I have worked closely with all interested parties in the development of this legislation, including industry, labor, consumer groups, the coal industry, electric utilities, small businesses and regulatory bodies. We have adopted many of their suggestions. All have indicated their support of this legislation, which we hope can be enacted by the end of this year.

The ability of our basic industries to be competitive depends in large part on their ability to compete on the basis of price with other domestic and foreign producers. Energy consumption is a major factor in a

product's price, and can literally make the difference on whether a plant stays open or closes down. To the extent that we can control energy costs and keep prices competitive, we can maintain our traditional "smokestack" industries as well as attract new service industries. It is important to realize that in the last ten years, Pennsylvania increased its stock of new jobs by less than one percent -- the fourth worst record in the nation. At the same time, national employment grew by 14 percent.

Cogeneration is one of the best commercially available methods we have to reduce energy costs. This efficient and competitive way of producing usable power and steam or cooling in a single process has great potential for more competitive pricing of Pennsylvania's products and services. Important savings can also be realized by small businesses, educational institutions and hospitals -- all of which are struggling to contain escalating costs.

Yet it is the very institutions and industries which can most benefit from cogeneration that have the least ability to take advantage of it, due to the significant capital costs involved at the outset. That is where the participation of utilities is key. Many gas utilities that are not registered under the Holding Company Act have successfully participated with industry in cogeneration projects, to the benefit of all parties and the nation as a whole.

Passage of this legislation will also benefit the nation's coal industry. According to the Department of Energy, coal will represent the dominant fuel in the development of cogeneration in the Ohio Valley. With coal scheduled to provide almost 60 percent of the region's cogeneration

project development, the potential Ohio Valley coal market could reach 25 million tons per year.

In addition, cogeneration development will spur those industries in the Ohio Valley which supply equipment and services to be installed in cogeneration facilities. The stimulus provided by this bill will increase demand for steam turbines, packaged engine-generator sets, coal/biomass boilers and stokers, waste heat recovery boilers, generators, switchgear, transformers and substations, instruments and controls, piping, structural and reinforcing steel, concrete and engineering and design services.

We have approximately 3,000 megawatts of cogeneration potential in Pennsylvania, which could translate into statewide energy savings of over $700 million a year. Even the implementation of just a fraction of the total number of potential industrial projects forecast by the Pennsylvania Energy Council could have major impacts on commerce and industry within the State.

These gas companies have the financial resources, expertise and incentive to engage in the development of cogeneration projects. We need to make the necessary clarifications in the current law to make that possible.

Finally, Mr. Chairman, I want to emphasize that our legislation is strictly and narrowly focused on allowing these three companies to share with other gas companies the right to own and operate qualified cogeneration facilities. The bill is free-standing, and amends neither PUHCA nor any

other existing legislation. It would not alter the SEC's general regulatory jurisdiction over the companies, and all the comprehensive SEC financial reporting and accounting principles would remain intact.

I thank you for taking the time to hold these hearings today, and urge your expeditious consideration of S. 727. My hope is that we can complete work on this bill by the end of the year, and I want to commit to you that the House sponsors stand ready to work with you toward speedy passage.

Senator HEINZ. Congressman Walgren, thank you for making the journey over from the other body; we appreciate your testimony. Some people in the audience may be wondering why this legislation is necessary, since virtually everybody agrees that cogeneration is supposed to be encouraged. It makes sense. We voted in favor of it back in the 1978 act. And what should be done with the three companies affected by the legislation?

BY ACCIDENT OF GEOGRAPHY

The short answer is that the three companies that you and I happen to be, by accident of geography, concerned with are the only three gas companies in the United States that are currently registered under the Public Utility Holding Companies Act of 1935. Somewhere along the line, history just conspired to have those three companies so registered.

As a result, they have gotten caught in an SEC ruling which has determined that cogeneration is not consistent with being in the business of a gas utility. We simply, by virtue of this legislation, allow those three companies to do what all the other gas utilities in the country do, which is, if they want, to engage in cogeneration.

I thank you for your eloquent testimony in that regard. And, clearly, as you point out, the benefits to our region are very important. We need all the help that we can get when it comes to making sure that our basic industries are competitive. And this certainly will help.

I note Senator Cranston is here, our distinguished minority whip.

Senator CRANSTON. Thank you very much, Mr. Chairman. I'm sorry I missed your testimony. I came by just to indicate my solidarity with you and your colleagues on the House side on this measure. I'm all for cogeneration. I want to see if we can move it right away, which I'm sure it will.

Mr. WALGREN. I appreciate that very much.

Senator HEINZ. Thank you for that. It's very much appreciated.

I have no questions for you. I won't even ask you, as my Congressman, what you've done for me or my constituents lately. I get your newsletter. [Laughter.]

Mr. WALGREN. We'll be able to use that. [Laughter.]

Thank you very much.

Senator HEINZ. Thank you, Doug.

Our next panel consists of Richard McClelland of Consolidated Natural Gas Co., and Gerald Currier of Niagara Mohawk Power Corp.

Gentlemen, please come forward.

STATEMENT OF RICHARD H. McCLELLAND, GENERAL MANAGER, CNG ENERGY CO., CONSOLIDATED NATURAL GAS CO.

Mr. MCCLELLAND. Mr. Chairman, members of the subcommittee, I'm Dick McClelland, general manager of CNG Energy Co., a wholly owned nonutility subsidiary of Consolidated Natural Gas Co. [CNG]. I've been working for industrial customers in our service region for over 2 years to assess the benefits of cogeneration. This has involved over 30 industrial customers and a number of institutions, including hospitals and universities. The effort has encompassed the States of New York, Pennsylvania, West Virginia, and Ohio.

Senator HEINZ. Could I just ask you to hold for 1 second, Mr. McClelland? I'm sorry. I was interrupted by staff. I meant to put something in the record before you started.

Mr. MCCLELLAND. Excuse me.

Senator HEINZ. First, I want to include in the record at the appropriate point a letter from my colleague, Senator Specter of Pennsylvania, to Senator D'Amato, voicing his support for this measure and indicating that we very much appreciate, as do I, Senator D'Amato's cooperation in holding this hearing.

[Letter from Senator Specter to Senator D'Amato follows:]

ARLEN SPECTER
PENNSYLVANIA

COMMITTEES
JUDICIARY
APPROPRIATIONS
VETERANS' AFFAIRS
INTELLIGENCE

United States Senate
WASHINGTON, DC 20510

September 13, 1985

The Honorable Alfonse D'Amato
Chairman
Senate Banking Subcommittee on Securities
United States Senate
Washington, D.C. 20510

Dear Senator D'Amato:

I am writing to lend my voice in support of the measure currently before your Subcommittee, S. 727, which would amend the Public Utility Holding Company Act of 1935 to allow three gas utility holding companies to engage in cogeneration. I ask that my comments be inserted into the record of these proceedings.

My home state of Pennsylvania will stand to gain substantially form this legislation, both directly and indirectly. In a straightforward sense, the energy savings as a result of this measure could reach, according to a recent Department of Energy study, some $700 million in Pennsylvania alone. In the regions of the Commonwealth which have not benefitted from this nation's economic recovery, these savings could translate into the creation of new jobs and the preservation of existing ones.

Further, through these energy savings, companies can afford to expand and improve their operations. Without a heavy burden of energy costs, industry can go about the business of business--producing, servicing, and manufacturing with an eye toward expansion in their markets. A commitment to cogeneration is a commitment to maintain and improve a business. This type of commitment is vital to the economic welfare of my constituents.

Indirectly, the effects of this legislation are just as dramatic. If a business can maintain operations as a result of lower energy costs, the community in which that business operates will continue to benefit from its presence. Unfortunately, because smaller utilities do not have the ready capital to invest in cogeneration, it has not become a prevalent activity among these utilities. S. 727, by allowing companies with the capital to engage in cogeneration to do so, would change that.

It is my sincere desire to see S. 727 passed by the Senate in the near future. This legislation, if acted on promptly, can have an immediate and vital effect on the economic and energy-related well being of Pennsylvania and the entire nation.

Sincerely,

Arlen Specter

AS/jdb

Senator HEINZ. Second, we have statements from a number of other organizations—Premix Inc., Fairmont General Hospital, Burrows Paper Corp., and National Fuel Gas Co.

I would ask that those appear in the record. Without objection, that is so ordered.

Finally, we wish to include in the record the SEC's no action letter regarding the CNG Energy Co.'s request to participate in the development of cogeneration facilities. That will appear also subsequent to the statements received from the previous mentioned corporations.

Also, it would be the Chair's intention to leave the record open for written questions both from other members and perhaps from the Chair, because we anticipate more votes.

So let me apologize to you, Mr. McClelland, for interrupting you. But, please pick up.

Mr. MCCLELLAND. Excuse me, Mr. Chairman. I would like to give you a brief summary of a written statement and ask that our full statement be entered into the record. Ral Murray, who is president of Consolidated, was originally scheduled to testify today and regrets that he cannot attend because of the change of time of the hearing. However, we both appreciate the opportunity to speak for Consolidated Natural Gas, National Fuel Gas, and Columbia Gas on behalf of S. 727.

BILL HAS A SINGLE PURPOSE

This simple bill has but a single purpose: It will permit the three gas companies still registered under the Public Utility Holding Company Act to own and operate cogeneration facilities just like all other gas companies. These preregistered gas companies—Consolidated, National Fuel, and Columbia—are the major suppliers of natural gas to the Ohio Valley and to New York State. Large segments of this region's industrial economy have been hit by recession and exploited by foreign competition. Unemployment and economic stagnation are both evident. Our region does recognize the need to become more competitive, but it has not been able to take advantage of the obvious savings offered by cogeneration. A primary reason is that the region's three most logical candidates to lead the development of cogeneration, as you pointed out are the only three companies in the entire Nation prohibited from doing so. This results from a technical interpretation of the PUHCA.

Why are we the logical candidates? And why has the absence of these three gas companies been a factor in the region's dismal cogeneration record compared to the rest of the Nation?

In answering these questions it is important to understand that cogeneration is a highly efficient way of producing both thermal and electrical energy for the same fuel—or from formerly wasted heat. Its efficiency offers cost savings to industry and to hospitals, educational institutions, and to commercial businesses. Based on DOE estimates, cogeneration would save industrial consumers 15–18 percent of their energy costs. For our region, these savings would total $1.5 billion a year.

There's a clear role for gas companies in helping industry to achieve these savings. Thermal energy is the dominant output of a

cogeneration facility, between 70 and 90 percent. Thus, a cogeneration facility must be designed to meet the needs of the industrial customer from a thermal point of view. Gas companies like us have routinely dealt with such thermal needs for decades. Moreover, in our own operations, we three gas companies routinely install and operate gas turbines and gas engines which form the heart of many of the cogeneration systems used in other places in the Nation. Finally, we have a compelling interest for helping cogeneration take hold in our region. This is for a number of reasons. It will help make our local industry more efficient and cost competitive. It will preserve and add many jobs to the region, thereby strengthening old and adding or attracting new industry. Depending on the fuel type, it will benefit our markets directly or indirectly. It would also benefit our residential, commercial, and industrial gas consumers. Also, we hope to make money from the ownership and operation of cogeneration facilities, and this will be done at no risk to our gas consumers. Thus, there are strong motivations for us to develop cogeneration.

As you pointed out, there is an equally strong need in our region for our involvement. The facts are very clear on this. Our region has achieved only 6 percent of its cogeneration potential as estimated by the DOE. This compares with over 28 percent for California, nearly 40 percent on the gulf coast, and over 20 percent on the average for the Nation as a whole.

We have helped a number of regions' industrial plants and other energy users to assess cogeneration. While they both understand and appreciate its benefits, our region's industry has not invested in cogeneration for several reasons. Their capital resources are generally constrained. Their first priority is to modernize plant and production facilities. Cogeneration requires a large, upfront investment.

PROSPECT OF THIRD-PARTY OWNERSHIP

As you might expect, industry's interest in cogeneration has increased dramatically with the prospect of third-party ownership. Indeed, some 70 percent of the cogeneration products undertaken elsewhere in the Nation are by third parties, such as gas companies. But there continues to be a vacuum of leadership in our region.

With S. 727, Consolidated and the two other gas companies would assume that leadership role. Developing only 25 percent of the region's cogeneration potential would create an additional demand for over 44 billion cubic feet of natural gas and 7 million tons a year of coal.

Regional use of both these fuels has fallen over the past decade. For example, due to a number of factors, including plant closings, the region's industrial gas sales have fallen 300 billion cubic feet a year, a loss of almost 35 percent over the decade. This has tended to shift the fixed costs of gas distribution and transport to residential, commercial, and remaining industrial consumers, increasing their costs. Cogeneration will help mitigate that trend.

Cogeneration development will also open a whole new, environmentally sound market for steam coal, which we estimate would be

worth $200 million a year at present prices. This can help to offset a 50-percent decline in the region's industrial coal use over the last decade. Cogenerational coal use would translate it into creating 4,000 mining and related jobs, and also create $70 million in new business annually for the region's coal carriers. Suppliers of equipment and services will also benefit.

Just 25 percent of DOE's estimated cogeneration potential would create a $2.5 billion market for equipment, services, and construction. Thus, not only would the region's industry benefit directly and indirectly from cogeneration savings; but they would also have a role in supplying the goods and services needed in putting the region's cogeneration into place.

However, these many benefits are presently denied by strict technical interpretation by which the SEC feels constrained, even though it does not object on policy grounds to our participating in generation development. S. 727 merely removes this interpretative roadblock. It does not amend PUHCA or any other statute; nor does it tamper with any of the issues or safeguards in PUHCA or related acts.

S. 727 boils down to two questions. Shouldn't our region be given the chance to obtain the benefits of cogeneration along with the rest of the country, as Congress clearly intended? Second, shouldn't the region's three major gas companies be permitted like all other gas companies to own and operate cogeneration, when such permission can be granted without otherwise affecting PUHCA?

Simply to state these questions, is to state the need for, and the fairness of, timely action on S. 727. This bill will release three native sons, clearly qualified for the assignment, to help their community get solidly back on its economic feet by closing the cogeneration gap between our region and the rest of the country.

Thank you. I will be pleased to answer any questions which you may have.

[Complete prepared statement follows:]

WRITTEN STATEMENT

OF

CONSOLIDATED NATURAL GAS COMPANY

SUBCOMMITTEE ON SECURITIES

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

SEPTEMBER 17, 1985

Mr. Chairman and members of the Subcommittee, my name is Richard H. McClelland. I am the General Manager of CNG Energy Company, a wholly owned, non-utility subsidiary of Consolidated Natural Gas Company, headquartered in Pittsburgh, Pennsylvania. I am representing Consolidated at this hearing because I am currently guiding all of Consolidated's cogeneration activities. I greatly appreciate the opportunity to discuss with you today S.727, a simple and noncontroversial bill aimed solely at permitting the three natural gas companies still registered under the Public Utility Holding Company Act of 1935 ("PUHCA") to participate in cogeneration. Consolidated is one of these three companies.

I appear not only for Consolidated, but also on behalf of the National Fuel Gas Company and of the Columbia Gas System, the two other remaining gas utility holding companies still registered under PUHCA and whose gas distribution companies or wholesale gas transmission systems are also predominately located in the Ohio Valley and in upstate New York. Both fully support my statement.

The energy savings obtainable from cogeneration could be important to virtually everyone in the Ohio Valley and in New York State. This highly industrialized area, as you know, has been seriously impacted by the past

recession. It also faces growing, foreign competition. Despite its serious need to become more competitive, this region has failed to take advantage of the economic savings offered by cogeneration to the same extent as have other industrial regions of the nation. This anomaly has occurred, in large part, because three of the best qualified candidates to lead the way in the Ohio Valley and in New York State are uniquely prohibited from doing so by a strict, technical interpretation of PUHCA by the SEC. Besides manufacturers, commercial businesses, hospitals, universities, gas consumers, both the gas and coal industries, and specialized cogeneration suppliers, among others, will benefit from establishing cogeneration in this region.

Before developing these points, I should mention that this paper contains a number of estimates to highlight the economic benefits that could be realized from establishing cogeneration in this region. The informational sources that were used in making each of these estimates and the manner in which they were calculated are explained in a brief appendix included with this testimony. Incidentally, the "Ohio Valley" referred to in this testimony includes the states of Kentucky, Pennsylvania, Ohio and West Virginia. My many references to the word "region" includes New York State along with the Ohio Valley states. New York, which abuts the Ohio Valley, can similarly benefit from an active cogeneration program.

Cogeneration Reduces Energy Costs

Cogeneration reduces industrial energy costs through more efficient fuel use. This efficiency results from the concurrent production of industrial thermal energy -- usually in the form of steam -- and electrical energy, from the same source of fuel or from formerly wasted heat. The electricity is typically sold to the local electric utility for distribution through its network, but can

occasionally be used by the steam customer itself. The steam requirements of the industrial plant are provided at significantly lower cost through cogeneration than through conventional boilers. A 1984 study sponsored by the Department of Energy calculates that cogeneration would produce 15% to 18% in average energy savings for the five major energy-consuming industries.

These five industries -- food, paper, chemicals, petroleum and primary metals -- are highly visible throughout the Ohio Valley and New York State. We have estimated, using DOE figures, that these industries alone could save over $1.5 billion annually in energy costs in the region at the level of cogeneration development projected by DOE. Such savings are not surprising when you consider that energy comprises up to 30% of the cost of the materials used by such manufacturers.

Cogeneration in the Ohio Valley Remains Below Expectations

Ironically, despite the importance of cogeneration savings to its industries, the Ohio Valley lags behind the rest of the nation by a ratio of almost 6 to 1 in cogeneration development. According to applications filed with the Federal Energy Regulatory Commission since 1980, California has already reached almost 30% of its cogeneration potential; the southern oil and gas producing states, almost 40% of theirs. The nation as a whole has realized almost 20% of its industrial cogeneration potential. This contrasts sharply with the 3.5% of potential thus far achieved by Ohio Valley industry.

The Ohio Valley and New York State are trailing because no one in this area is leading the way. Industries here are not investing in cogeneration for four major reasons: their capital resources, for the most part, are strained; their first priority is to modernize aging plant and production facilities; cogeneration requires a large, up-front investment; and, as a group, they lack the energy expertise to develop and operate cogeneration

systems. Even if it were willing, a small industrial company, to obtain the long-term savings of cogeneration, would have to invest many times the $1.25 million it would normally pay for replacing a conventional gas boiler.

As would be expected, industry's interest in cogeneration increases substantially when presented with the prospect of thi-d-party financing and ownership. Third-party financing comprised over 70% of all cogeneration projects which were successfully closed during 1984. Consolidated has noted a strong interest in outside ownership among its customers and others while assessing for them the potential of cogeneration energy and cost savings. These assessments have included, among others: a major steel mill in Pennsylvania; two heavy and six light industrial manufacturers, a hotel, YMCA, shopping mall and county office building in Ohio; several glass companies, a proposed new paper mill, and a major university in West Virginia; three paper mills, three chemical plants, a food processor, an automotive supplier and a large pharmaceutical plant in New York; and a number of hospitals and medical centers in each of these states.

The Three Gas Companies Are Ready, Willing and Able

The three companies to which S.727 pertains -- Consolidated, National Fuel and Columbia -- possess the financial resources necessary to become third-party owners and operators of cogeneration facilities. They will invest in cogeneration because cogeneration will help meet many of the present needs of these three companies: it will make better gas customers out of many local industries by helping them become more efficient and better able to stand up to growing foreign competition; it will preserve and add many jobs in the region by strengthening old, and attracting new, industries; it will contribute to the economic health of the communities served by the three companies; and cogeneration will create an attractive new market for industrial gas in the Ohio Valley.

It will also allow fuller utilization of the talents and experience these companies have acquired in the gas business. Cogeneration facilities are designed to match the thermal needs of the industrial, institutional or commercial customer. These needs are well understood by gas companies, who have been routinely satisfying them for decades. Moreover, gas companies regularly purchase, install and operate gas turbines and gas engines for their own pipeline compressor stations and gas production operations. These same types of gas turbines are the heart of many of the industrial cogeneration systems presently being built, as are gas engines for the cogeneration systems being installed at hospitals, universities and commercial businesses.

The active cogeneration involvement of other large gas companies throughout most of the nation attests to the close operational relationship between cogeneration and the natural gas business. However, this involvement is not found in the Ohio Valley and New York State. A major reason, of course, is that the three gas companies which primarily serve this industrial region are currently prohibited from participation.

S.727, if Enacted, will Spread Diverse Benefits throughout the Region

Once in place, cogeneration will give the stagnating Ohio Valley and New York State economies a long overdue boost. Nonagricultural employment in this area has grown only 4% over the past decade compared to the 21% average growth enjoyed by the rest of the nation. This difference means that by failing to keep pace with the rest of the nation, this region has "lost" three million jobs. In this connection, it is important to keep in mind the Department of Commerce estimate that for every manufacturing job preserved or added by cogeneration, an additional 1.6 jobs indirectly related to the manufacturing job will likewise be preserved or added.

The natural gas consumer and the natural gas industry will also benefit as cogeneration develops in the region. Based on DOE estimates, developing 25% of the region's cogeneration potential could add an annual gas load of 44 billion cubic feet (Bcf). This will help offset a long-term 700 Bcf decline, mostly industrial, in the region's gas sales over the last decade.

Local gas distributors and their customers will benefit because this incremental demand will help hold down gas prices by spreading the fixed cost of retail gas distribution and wholesale transport facilities over greater sales volumes. These fixed costs, principally the gas industry's multibillion dollar investment in existing transmission pipelines and distribution systems, account for some 30% or more of the delivered price of gas. This becomes even more important given the current trend of declining industrial gas sales, resulting in part from plant closings, to shift fixed costs to residential and commercial gas consumers as well as remaining industrial customers.

In addition to gas, coal will serve as an equally important fuel for Ohio Valley and New York cogeneration. Third-party cogeneration developers such as Consolidated can provide a mechanism for financing the higher cost of coal-fired cogeneration systems and their required state-of-the-art pollution controls, including the ability to co-burn gas and coal. Even with coal-firing, cogeneration development would help to preserve process gas loads for the three companies as well as satellite gas loads at supportive industrial and commercial businesses in the community, and also residential gas loads among the many employees involved. Thus, an active cogeneration program in the region can also create a whole, new industrial steam coal market.

Using DOE data, we calculate that, in addition to the increased gas demand discussed earlier, just 25% of the region's industrial cogeneration

potential could yearly generate seven million tons of coal purchases, a market worth almost $200 million at present prices. This would lead to 2,400 regional mining jobs and 1,900 indirect jobs. It would also generate $70 million annually in new markets for the region's coal carriers -- a mix of rail, truck and barge transport.

This coal demand will not simply be a replacement for coal use at central power plants. Eighty to ninety percent of the energy typically produced from a coal-based or coal/natural gas co-burning cogeneration facility is steam for industrial use. It is this large steam use which sets the size of the coal market for the region's cogeneration; not electricity, which accounts for the remaining 10% to 20% of the facilities' output.

There are still others who will benefit importantly from Ohio Valley and New York State cogeneration. As mentioned earlier, a cogeneration facility involves a major purchase of specialized cogeneration equipment, labor and services. We conservatively estimate that Ohio Valley developers will spend $2.5 billion dollars in building cogeneration facilities. This market is based upon the development of only 25% of the Ohio Valley cogeneration potential identified by DOE.

Consolidated believes that the three registered gas companies can provide the missing leadership needed to get cogeneration truly going in the Ohio Valley and New York State. As do the other two registered gas companies, we understand the energy requirements of industry in this region. No company possesses any greater knowledge of cogeneration's thermal technology and equipment as they relate to the region's potential customers, irrespective of whether the fuel employed is natural gas or coal. The operation of cogeneration plants largely parallels what we do at our pipeline compressor stations and as

part of our platform production operations. No company has any greater understanding of gas supply and transport so vital to many cogeneration projects. And no company has any stronger motivation for wanting to help this region secure the many benefits of cogeneration. This is our home and we are naturally and deeply interested in, and dependent upon, its long-range economic fortune. We see no reason why every other gas company in the United States may use cogeneration to help preserve the respective markets they have painstakingly established, while the three of us may not.

In briefly recapitulating the many benefits expected to flow from the enactment of S.727 and the ensuing development of cogeneration in New York State and the Ohio Valley, I want to emphasize that this region's manufacturers and their working and currently idled employees are not the only beneficiaries. Businesses and institutions such as hospitals and universities will benefit from cogeneration's lower energy costs. The three gas companies themselves will be better able to sustain their established markets and to attract needed new industry to the region. Their customers, in turn, will benefit from the distribution of gas industry fixed costs over higher sales volumes. Cogeneration will also provide an expanded market for industrial steam coal, aiding the region's depressed coal industry and their employees. Finally, those involved in financing, designing, building, equipping and maintaining the cogeneration facilities from which all this will spring, will also benefit.

No Policy Reason Exists for Treating the Three Registered Gas Companies Differently from Other Gas Companies

The SEC apparently does not object on policy grounds to the participation of these three registered gas companies in cogeneration, nor is it averse to their involvement. The SEC's concern is based entirely upon a strict

technical interpretation of PUHCA. The proposed bill simply removes this interpretive roadblock and clarifies PUHCA so far as the cogeneration involvement of these three companies is concerned. The bill does not amend PUHCA or any other statute; nor does it tamper with any of the broad conceptual issues and safeguards embedded in PUHCA. The financing of a proposed "qualifying cogeneration facility" by Consolidated, National Fuel or Columbia will still require SEC approval. The cogeneration activities of the three companies will still remain subject to the SEC's rules and regulations and its comprehensive financial reporting and accounting procedures in the same manner as all other activities of registered gas holding companies.

In summary, the many areas I have highlighted boil down to two questions:

(i) Should a region that stands to gain the most from cogeneration be given the chance to obtain its benefits along with the rest of the nation, as Congress clearly intended?

(ii) Should the three major gas companies serving this region be permitted to own and operate "qualifying cogeneration facilities," just like all other gas companies throughout the nation, when such permission can be granted without otherwise affecting in the slightest any current statutory requirements of PUHCA or related acts?

In my opinion, simply to state these questions is to confirm why S.727 is a clearly needed and timely answer.

The enactment of S.727 would release three native sons, clearly qualified for the assignment, to help their community get solidly back on its economic feet by closing the cogeneration gap between this community and the rest of the country.

Thank you. I will be pleased to answer any questions which you may have.

APPENDIX

The table below illustrates how cogeneration development has largely bypassed New York State and the Ohio Valley. The source of the estimated potential by state and region is the Department of Energy study "Industrial Cogeneration Potential (1980-2000) Targeting of Opportunities at the Plant Site," first produced in May 1983. The "Actual Implementation" shown in this table reflects filings for Qualified Cogeneration Facilities made with the FERC from March 1980 through June 1984.

Region	Industrial Cogeneration Potential	Actual Implementation	Percent Realized In Last Four Years
California	7,316 megawatts*	2,065 megawatts*	28.2%
New England	3,392	643	19.0
New York and New Jersey	2,742	240	8.8
Ohio Valley States	5,503	195	3.5
Oil and Gas Producing States	8,439	3,321	39.6
Remaining States	15,432	1,961	12.7
Total:	42,824 megawatts*	8,425 megawatts*	19.7% average

According to the DOE studies, the primary fuels for New York State and Ohio Valley cogeneration would be natural gas and coal, along with some paper-mill-type wood waste. We estimate that development of 25 percent of the region's cogeneration potential would result in additional demand for 44 billion cubi feet of gas and 7 million tons of coal a year. This estimate is

*Although cogeneration produces mostly thermal energy, plant size and cap have been traditionally expressed in units of electrical energy. We maintained that practice so as to be consistent with outside sources and

based on DOE's projection of the relative market share for the two fuels. It has been cross-checked with site-specific assessments of potential cogeneration projects in Consolidated's retail and wholesale markets, which include major areas of Ohio, Pennsylvania, West Virginia, and New York State. These analyses include detailed studies by Lucien J. Luckel and Associates, engineering consultants, and are consistent with projections cited by outside sources and publications.

The increased demand for gas resulting from cogeneration development would, at least, partially offset the region's historic and substantial decline in other gas loads, which has acted to shift a greater burden of pipeline and distributor fixed costs to residential, commercial and remaining industrial gas consumers. According to Moody's Public Utility Manual and The American Gas Association's "Gas Facts," gas sales in the Ohio Valley region fell 700 billion cubic feet, or 25 percent, from 1973 to 1983, as set forth in the table below. The same sources show that industrial sales led the decline, plum-meting by about 35 percent.

Gas Sales In:	1973	1983
Kentucky	190 Bcf	141 Bcf
New York	575	552
Ohio	1,056	675
Pennsylvania	744	565
West Virginia	157	98
TOTAL	2,722 Bcf	2,031 Bcf

The decline in Ohio Valley industrial coal use has been even more severe. Data reported in the April 1984 "Coal Distribution" published by the DOE Energy Information Administration, and "Coal Data 1984" published by the

Keystone Bituminous Coal Association, record a drop of 56 percent from 1973 through 1983.

Industrial Coal Use in:	1973	1983
Kentucky	3.2 Million Tons	2.9 Million Tons
New York	8.3	3.6
Ohio	24.1	10.6
Pennsylvania	31.2	12.2
West Virginia	10.1	4.3
TOTAL	76.9 Million Tons	33.6 Million Tons

Based on DOE's projections, developing as little as 25 percent of the region's cogeneration would result in a new coal market worth $200 million a year using the composite price of coal purchases over a recent nine-month period as published in "Coal Week."

The potential $2.5 billion market for cogeneration equipment and services matches 25 percent of DOE's market and fuel use projections with engineering assessments of potential cogeneration projects at actual plants in the region, quotations from manufacturers and vendors of cogeneration equip-ment, and manning tables. Detailed studies by Lucien A. Luckel and Associates indicate an average installed equipment cost of $680 per Kilowatt (KW) for industrial gas-fueled cogeneration, and $1,800 per KW for industrial coal/biomass systems. A cost of $1,140 per KW for packaged gas engine cogeneration systems, as are used by hospitals, educational institutions and commercial energy users, is based on estimates by GRI-AiResearch plus vendor quotations and studies. All three calculations, which have been adjusted to include interest during construction, are consistent with estimates from a number of outside sources and publications. The following table shows the principal

cogeneration equipment and service purchases required to construct and develop 25 percent of the potential Ohio Valley market.

Thermal Equipment	$1,020	Million
Electrical Equipment	255	
Other Equipment and Supplies	360	
Design, Construction, and Financing	855	
	$2,490	Million

The attractiveness of this $2.5 billion market to equipment and service suppliers would be supplemented by expenditures of an additional $1.04 billion for maintenance and related supplies over the first ten years of facility operation. Moreover, both these initial and long-term purchases will result in indirect benefits to the local economies of cogeneration suppliers. According to the Department of Commerce, this secondary level of benefits, such as satellite jobs in the community, would equal 160 percent of the benefits.

Senator HEINZ. Thank you very much, Mr. McClelland.
Our next witness is Mr. Gerald Currier.
Mr. Currier, please proceed.

STATEMENT OF GERALD J. CURRIER, VICE PRESIDENT, NIAGARA MOHAWK POWER CORP.

Mr. CURRIER. Mr. Chairman, Senator D'Amato, I am Gerald J. Currier, vice president of Niagara Mohawk Power Corp. This utility, with headquarters in Syracuse, NY, supplies electricity to meet the needs of nearly 1.4 million customers. Our service area, encompassing more than half the land mass of New York, serves 669 communities with a population of 3.5 million people from Lake Erie to New England borders and from Canada to Pennsylvania.

We also distribute natural gas to 433,000 customers in central, eastern, and northern New York.

CONCERN FOR CONTROLLING ENERGY COSTS

Although large in its service operations, Niagara Mohawk gives a priority to meeting the individual energy concerns of its consumers. Our concern for controlling energy costs is reflected in our support and endorsement of legislation and proposals that provide methods of alleviating the impact of energy costs.

One such proposal is the introduction of Senate bill 727, a bill in which I and my company have a keen interest.

I thank you for the privilege of testifying on its behalf.

In the last decade, electric utilities across the Nation have been faced with the difficult problem of forecasting electric usage and developing properly sized central powerplants in a world of ever changing fuel costs, environmental constraints, and regulation.

Congress, recognizing the energy problem of the country and the instability of the world oil supplies established through PURPA a viable means of encouraging the development of cogeneration. Niagara Mohawk, like other utilities across the Nation, has supported and endorsed the development of these power resources. Niagara Mohawk's support is manifested most visibly in Hydra-Co Enterprises, Inc., a wholly owned subsidiary of our company, created in 1981. Hydra-Co participates in the development, ownership, operation, and maintenance of cogeneration plants and alternate energy products.

Our objective is to provide economical electric energy for our consumers, while forestalling and minimizing the heavy financial burden of additional large central generating plants. Such large plants require anywhere from 10 to 14 years from initial concept to completion. The difficulties of accurate energy forecasting and changing regulatory requirements make it not only proper but absolutely necessary to develop all untouched energy resources in our country.

Now, 3 years ago, our Hydra-Co subsidiary and Consolidated Natural Gas agreed to jointly carry forward the work of developing cogeneration in our service areas. In this instance, we jointly looked at an area not only covering New York State but also Ohio, Pennsylvania, and West Virginia.

Cogeneration, while not a new concept was never fully developed in past years because of the economics of central plant development. These economics no longer hold and the efficient use of fuel demands a serious consideration of the development of cogeneration facilities. Cogeneration facilities, economically developed and properly incorporated into the electric network, can reduce financing costs of electric utilities, delay large cash requirements for central plan development, and provide a means of more sensibly matching the varying and somewhat clouded forecast of energy requirements.

WILL PROVIDE INCREASED EMPLOYMENT

The development of cogeneration will provide increased employment and increased tax base, both vitally needed in the States previously mentioned.

The wide range of electric energy needs and forecasts indicate the difficulty of accurately forecasting the future. To meet this uncertain requirement in small economic increments is advantageous to everyone. Certainly, the ability to deal with smaller incremental plants will permit the energy makers to adapt a wide range of fuels with relative freedom from cost overruns, schedule delays, and similar problems. Cogeneration and its development, done in an economical and efficient manner, properly integrated into the electric system and priced under properly and fairly calculated rates, is a vital means of energy supply, which we cannot afford to forsake.

Cogeneration is adequately being developed in such areas as California and the gulf coast, but there are voids in other parts of our country. Electric and gas utilities have begun to take a prominent place among the third-party owners. This is understandable, not only because of the facts previously mentioned, but because of their expertise and knowledge of the energy business and their familiarity with energy production and transport and their ability to understand and cope with regulatory requirements of licensing and permitting.

It is surprising in this day and age to find that three of the most logical candidates to assume ownership and operating roles are restrained from doing so by a technical interpretation of the Public Utility Holding Company Act.

This is the focus of my remarks.

We need the support of this committee to remove the barrier that has prejudicially stunted the growth of cogeneration in New York, Pennsylvania, Ohio, and West Virginia, in which Consolidated Gas Co. operates, and particularly in New York where both our companies operate.

Certainly, the Senators and Representatives who enacted PURPA thought they were creating the opportunity of developing the energy sources discussed equally in all parts of the Nation. Consolidated Gas is one of the three remaining registered gas holding companies. This legal barrier has thus far grounded the intended partnership of Hydra-Co and Consolidated. I state unequivocally that the expertise of both are necessary and proper for the development of cogeneration in the region.

The existing legal barrier has deprived New York and its neighboring States of the independent leadership of Consolidated and two other registered gas holding companies.

I trust the committee will recognize the need for the removal of this barrier and will thus provide resources through third-party development that will aid our region and its older industries. The benefits argue strongly for the passage of Senate bill S. 727.

Thank you.

[The complete prepared statement follows:]

STATEMENT BY GERALD J. CURRIER

VICE PRESIDENT OF

NIAGARA MOHAWK POWER CORPORATION

TO

SUBCOMMITTEE ON SECURITIES

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

SEPTEMBER 17, 1985

Mr. Chairman and members of the Subcommittee. I am Gerald J. Currier, Vice President of Niagara Mohawk Power Corporation. This utility, with headquarters in Syracuse, New York, supplies electricity to meet the diversified needs of nearly 1.4 million customers. Our service area, 24,000 square miles across Upstate New York, extends from Lake Erie and Pennsylvania on the west to the borders of New England on the east and from Canada on the north to the borders of Pennsylvania on the south. We also distribute natural gas to 433,000 customers in central, eastern and northern New York. In 1984 we produced and distributed over 37 billion kilowatt-hours of electricity making use of our utility plant valued at $5.4 billion.

I wish to thank you for the privilege of testifying on behalf of S.727, a bill in which I and my Company have a keen interest.

In the last decade, electric utilities across the nation have been faced with the difficult problem of forecasting electric usage and developing properly sized central power plants in a world of ever changing fuel costs, environmental constraints and regulation. All of this, during

times of high interest rates and high inflation.

Our Federal Government, recognizing the energy problems of the country and the instability of the world oil supplies, established through the Public Utility Regulatory Policies Act a viable means of encouraging the development of cogeneration. The Niagara Mohawk Power Corporation, like other utilities across the nation, has supported and endorsed the development of these power resources. Niagara Mohawk's support is manifested most visibly in HYDRA-CO Enterprises, Inc., a wholly owned subsidiary created in 1981. HYDRA-CO participates in the development, ownership, operation and maintenance of small hydroelectric plants, cogeneration plants and alternate energy projects. Our objective is to provide economical electric energy for our consumers while forestalling and minimizing the heavy financial burden of additional large central generating plants. Such large plants require 10-14 years from initial conception to completion. The difficulties of accurate energy forecasting and changing regulatory requirements make it not only proper but necessary to develop all untouched energy resources in our country. Three years ago our HYDRA-CO subsidiary and Consolidated Natural Gas agreed to jointly carry forward the work of developing cogeneration in our service areas. In this instance we jointly looked at an area not only covering New York State but also Ohio, Pennsylvania and West Virginia. Cogeneration, while not a

new concept, was never fully developed in past years because of the economics of central plant development. These economics no longer hold, and the efficient use of fuel demands a serious consideration of the development of cogeneration facilities. Cogeneration, in simple terms, is the burning of a fuel resulting in the production of two products; namely, hot water and/or steam and electricity. The efficient use of fuel in this manner is unquestionably not only an advantage to our country but can prove advantageous to the customers of electric utilities and to industries and commercial institutions. Cogeneration facilities economically developed and properly incorporated into the electric network can reduce financing costs for electric utilities, delay large cash requirements for central plant development and provide a means of more sensibly matching a varying and somewhat clouded forecast of energy requirements. The development of cogeneration provides employment and increased tax base, both vitally needed in the states previously mentioned.

I do not believe in long winded reports quoting many substantiating facts from various studies. I can only refer you to the studies of the Department of Energy and the North American Electric Reliability Council on predictions of electric energy needs by the end of the century. The wide range of their forecasts of approximately 255,000 megawatts shows the difficulty of accurate forecasts. To meet this

uncertain requirement in small economic increments is advantageous to everyone. Certainly, the ability to deal with smaller incremental plants permits the energy makers to adapt a wide range of fuels with relative freedom from cost overruns, schedule delays and similar problems that are apt to trouble larger projects with long planning and construction lives.

In addition, another benefit is third party ownership of such plants. Each project is normally surrounded by its own financial wall as a result of self-contained project financing, reducing the risk to the utility or utilities involved. The individual plant owners are responsible for obtaining their own fuel, relieving the utility of that added fuel purchase and inventory responsibility associated with generation, thus reducing the risk to that company and its customers.

Cogeneration and its development, done in an economical and efficient manner, properly integrated into the electric system and priced under properly and fairly calculated rates, is a viable means of energy supply which we cannot afford to foresake. Cogeneration is actively being developed in such areas as California and the Gulf Coast, but there are voids in other parts of our country. Electric and gas utilities have begun to take a prominent place among the third party owners. This is understandable, not only because of facts previously mentioned, but because of their expertise and knowledge of the energy business, their familiarity with energy production

and transport and their ability to understand and cope with regulatory requirements of licensing and permitting.

It is surprising in this age and time to find that three of the most logical candidates to assume an ownership and operating role are restrained from doing so by a technical interpretation of the Public Utility Holding Company Act. This is the focus of my remarks. We need the support of this Committee to remove the barrier that has prejudicially stunted the growth of cogeneration in the aforementioned states in which Niagara Mohawk and Consolidated Gas operate. Certainly the Senators and Representatives who enacted PURPA thought they were granting the opportunity of developing the energy sources discussed equally to all parts of the nation. Consolidated Gas is one of the three remaining registered gas holding companies. This legal barrier has thus far grounded the intended partnership of HYDRA-CO and Consolidated. I state unequivocally that the expertise of both are necessary and proper for the development of cogeneration in the region. The existing legal barrier has deprived New York and its neighboring states of the independent leadership of Consolidated and two other registered gas holding companies.

I trust the Committee will recognize the need for the removal of this barrier and will thus provide resources through third party development that will aid our region and its older industry. The benefits, weighed against the strict interpretation of a law that would lose none of its force from the simple bill before you, argue strongly for the passage of S.727.

Senator D'AMATO [presiding]. Thank you very much.

Let me at this time submit my statement for the record, as if read in its entirety.

[The complete prepared statement follows:]

STATEMENT OF SENATOR ALFONSE M. D'AMATO

This afternoon, the subcommittee will address S. 727, legislation which is designed to permit the Nation's three registered gas utility holding companies to own or operate cogeneration facilities. At present, these three gas utility holding companies are legally barred from investing or participating in the development of cogeneration facilities by the Public Utilities Holding Company Act of 1935.

S. 727 is limited to removing this legal bar which the SEC imposed upon these three companies when the Commission determined that cogeneration activities were not "functionally related" to their primary role as gas distributors. Although S. 727 amends PUHCA, registered gas utilities companies wishing to participate in cogeneration projects will still have to obtain SEC permission to acquire assets, securities, and other interests. The SEC will obtain its full investigatory and enforcement powers over these companies and the ability to forbid participation in cogeneration activities which are not in the public interest. This legislation is not designed to repeal the Public Utilities Holding Company Act.

S. 727 accomplishes another purpose—which is to promote the development cogeneration facilities in a manner which is consistent with the congressional intent of the Public Utilities Regulatory Policies Act of 1978. In certain portions of the country, the development of cogeneration facilities has been impeded by a lack of private funds. S. 727 is designed to permit three companies, possessing the technical and financial ability to participate in the development of cogeneration facilities, to engage in such activity.

I want to welcome this afternoon's witnesses. Gentlemen the subcommittee appreciates your appearance and looks forward to your testimony.

As previously indicated, the record will be kept open, and Senator Heinz and I will submit questions on behalf of the subcommittee.

We'd appreciate your written responses to them.

We'd also indicate to you, as I indicated to Senator Heinz, that I believe that this legislation makes sense. It will reduce the cost of doing business, not only in Pennsylvania, in New York, and in other areas. Certainly, the legislation should be enacted as expeditiously as possible, and I am also going to cosponsor this legislative initiative.

So we are delighted to have your testimony, and as I have indicated, we will submit some questions to you for the record. We would appreciate your response. The record will be kept open for your statement and any others that members of the committee or other interested parties may wish to make. Hopefully, the chairman will be favorably disposed, and it will result in some legislative action to grant the relief that I believe you require.

So we are pleased with the fact that you could be with us today. It has been a busy legislative day.

This hearing stands in recess.

[Whereupon, at 4:30 p.m., the hearing was adjourned.]

[Response to written questions of Senators D'Amato and Heinz, along with additional material supplied for the record, follow:]

RESPONSE TO WRITTEN QUESTIONS OF SENATORS D'AMATO AND HEINZ FROM
RICHARD H. McCLELLAND AND GERALD J. CURRIER

Chairman D'Amato:

Is your desire to participate in the development of cogeneration facilities prompted by the need for the energy such facilities would produce? If you do not intend to use the energy produced by these facilities, who will? Why don't they invest their funds; why do these companies need your investment?

Mr. McClelland:

Cogeneration is a highly efficient way of producing both thermal energy -- such as steam or hot water -- and electricity from the same fuel. Its principal energy output is thermal energy, typically 70 to 90 percent of the plant's output in the form of steam, which would be supplied to an industrial plant or to an institutional energy user. This includes industrial employers -- such as in the paper, chemicals, primary metals, food processing, and light manufacturing businesses -- as well as hospitals, educational institutions, and commercial businesses. Industries in this region are not investing in cogeneration for a number of reasons: their capital resources, in many instances, are strained; their first priority is to modernize aging plants and production facilities; cogeneration requires a large up-front outlay for specialized equipment; and in many instances, they feel they lack the energy expertise to develop and operate a cogeneration facility.

Chairman D'Amato:

What do you perceive to be the benefits of increased reliance upon electricity produced through cogeneration as opposed to the production of electricity by nuclear power or large, coal-fired baseload plants? Has cogeneration proven to be an answer to the problem of short-term fluctuations in demand for electricity?

Mr. Currier:

A cost-efficient and reliable utility such as Niagara-Mohawk has a broad mix of various types of fuels and facilities in its generating and dispatch base. Clearly, there is a role for cogeneration in that mix. Cogeneration facilities economically developed and properly incorporated into the electric network can reduce financing costs for electric utilities and can delay large cash requirements for central plant development. Cogeneration can indeed provide a means of more sensibly matching a varying and somewhat clouded forecast of future electric energy needs.

Chairman D'Amato:

Will the use of energy from the cogeneration facilities in which you plan to participate be more cost efficient than the energy presently used by those companies? Will some of the end users of energy produced through cogeneration be better able to compete with foreign competition? How will this occur?

Mr. McClelland:

Because cogeneration produces two forms of energy -- thermal and electrical -- from the same fuel or from formerly wasted heat, it is indeed more cost efficient. Based on DOE estimates, cogeneration would save industry 15 to 18 percent of its energy costs. These same estimates indicate that industry in the region could save $1.5 billion each year based on its overall cogeneration potential. These substantial energy savings have been projected by DOE for the region because of its large number of major energy-consuming industries such as: food processing, paper, chemicals, petroleum, and primary metals. Such cogeneration savings can clearly help industry to be more cost competitive in meeting growing, foreign competition. Cogeneration also offers needed savings for hospitals, educational institutions, and commercial businesses.

Chairman D'Amato:

What impact will the production of energy through cogeneration have on promoting industrial growth and employment?

Mr. McClelland:

Cogeneration development will provide cost savings which will help industry in meeting growing, foreign competition. It can also aid in attracting new industry to our region. As an indication of the importance of cogeneration in preserving and adding jobs to the region, a paper mill has entered a letter in support of S.727, as has another manufacturer and a hospital. They clearly indicate the interest of industry and institutions in achieving the cost savings of cogeneration. Many of the region's manufacturers and labor would also be involved in supplying the specialized equipment, services, and construction needed to put the region's cogeneration into place.

Chairman D'Amato:

How will the enactment of S.727 increase your role in development of cogeneration facilities? What specific projects would you be likely to consider?

Mr. McClelland:

S.727 would simply allow the three registered gas holding companies to be like all other gas companies in the nation by being able to own and operate cogeneration systems, including through various joint venture arrangements with others. We would work with industrial customers as well as institutional energy users to assess and develop the best way of cogenerating their energy needs. This would include such firms as steel companies, chemical companies, paper mills, food processors, pharmaceutical manufacturers, automotive manufacturers, and many other types of light and heavy industrial plants -- along with hospitals, medical care centers, nursing homes, universities, and other institutional and commercial energy users. In Consolidated's case, it would also permit a unique cogeneration development venture between a gas company and an electric company to go forward. The resulting cogeneration effort would consider both gas and coal-fueled cogeneration.

Senator Heinz:

If cogeneration has so many advantages, why wouldn't industries in the region find third-party financing from sources other than Consolidated, National Fuel and Columbia?

Chairman D'Amato:

If cogeneration has so many advantages, why wouldn't industries that could benefit from cogeneration attempt to find companies other than Consolidated, National Fuel Gas, and Columbia Gas System to assist them if assistance is necessary?

Mr. McClelland:

There appear to be a number of reasons why industry in the region has not attracted the interest of outside sources of cogeneration development. For example, third-party developers, such as private investors and the large engineering and construction firms, are apparently more attracted to cogeneration projects in higher growth areas such as California and the Southwest. Also, with the exception of Niagara Mohawk, who has testified today in favor of S.727, the area's electric utilities have shown little interest in developing the overall region's industrial or other cogeneration potential. In addition, those gas companies which are active in cogeneration development elsewhere in the nation generally tend to stick close to home.

Chairman D'Amato:

How many cogeneration facilities are currently operating? How many new facilities will be built within the next five years? Are these facilities going to be fired with gas or coal? Who are the principal users of this energy -- are they small businesses or heavy industry? What types of energy demands or consumers are needed for cogeneration facilities to succeed? Will the cost savings which may result from the development of cogeneration facilities be passed on to consumers?

Mr. McClelland:

Based on DOE studies reported in 1983, there were approximately 400 cogeneration plants in the nation. From March 1980 through June 1984, FERC reports some 300 applications filed for new cogeneration facilities. This number does not include existing plants which also filed for "QF" status. Of course, not all of these newly filed facilities are in operation at this point -- and indeed some may never be built -- because the usual procedure is to file the QF application in advance of a construction commitment. Most of these applications were in California and in the oil and gas producing states in the Southwest.

There are a number of estimates as to the nation's future growth in cogeneration. One estimate is for about 1,000 megawatts per year from 1986 through 1990. On that basis and making the assumption that the Ohio Valley and New York State region were to realize its proportionate share of the nation's future cogeneration activity and benefits, about 700 megawatts or twelve percent of the region's present industrial cogeneration potential would be developed during this period. This would translate into about $200 million of annual energy savings for the region's industry. Of course, absent S.727's enactment, we see very little chance that Ohio Valley and New York State industry will acquire such savings. I should add that although cogeneration produces mostly thermal energy, plant size and capacity have been traditionally expressed in units of electrical energy such as megawatts. We have maintained this practice so as to be consistent with outside sources and data.

Based on DOE estimates and on our own assessments of cogeneration benefits for industrial customers and for institutions -- such as hospitals and universities -- in New

York, Pennsylvania, Ohio and West Virginia, we would expect to see the region's overall cogeneration to use a mix of gas and coal.

The principal output of cogeneration is thermal energy such as steam, hot water, or perhaps even hot air for a drying application. Thus, most cogeneration applications tend to be in energy using industries such as paper, chemicals, foot processing, petroleum and primary metals. These types of plants are a substantial part of the region's industrial base. Moreover, cogeneration can be of benefit to any manufacturer which has a reasonably sized and relatively steady steam load or similar thermal use. Cogeneration is also applicable to hospitals, educational institutions, nursing homes, health care facilities, YW and YMCAs, and commercial businesses. Thus, cogeneration can benefit a number of businesses -- both small and large --, heavy industry, and many other institutions.

The energy efficiency savings of cogeneration are passed on to the thermal user through providing his steam or other thermal need at a lower cost through cogeneration than through conventional boilers. This is done by a contract between the third-party cogenerator and the industrial, institutional, or commercial energy user. It is important to note that the energy user by entering into such an arrangement is, in effect, also making a long-term commitment to remain in business in the region.

Chairman:

In your testimony you indicate that the SEC has no problem in principle with letting the three registered gas utility holding companies participate in cogeneration activities. If this is the case, what reason has the SEC given you for denying you the opportunity to engage in cogeneration activity by its strict interpretation of the "functional relationship" standard in PUHCA?

Mr. McClelland:

The SEC has taken the position that the FERC exemption does not apply to registered gas holding companies. That exemption, promulgated under PURPA, excludes qualifying cogeneration facilities from being defined as "electric utility companies" under PUHCA. However, by not extending this same FERC exemption to registered gas companies, the SEC has treated their attempted cogeneration involvement as a utility, rather than a non-utility, acquisition. The SEC feels constrained by PUHCA to take this position even though a cogenerating registered gas company would no more resemble an electric utility then any other cogenerating gas company. Also, the SEC staff was unable to find a direct operating relationship between cogeneration and our company's gas utility operations. This "functional relationship" is required between a registered company's utility and non-utility activities under Section 11(b)(1) of PUHCA.

Chairman:

Critics of S.727 may argue that this legislation is not consistent with the goals that the authors of the Public Utility Holding Company Act of 1935 sought to achieve. What impact will S.727 have on the other provisions of PUHCA and can you explain why the enactment of S.727 is consistent with the legislative purposes of PUHCA?

Mr. McClelland:

S.727 does not amend PUHCA. It is a free-standing bill introduced for the purpose of clarifying Section 11(b)(1) of PUHCA to enable the three remaining registered gas companies to participate in cogeneration development like all other gas companies in the nation. PUHCA itself will not be affected.

PUHCA was aimed primarily at eliminating multiple corporate layers within utility holding companies, simplifying their financial structures, and integrating their operations. Permitting three gas holding companies companies to become involved in cogeneration does not violate any of these aims.

Chairman:

If S.727 is enacted, will the cogeneration activities of registered gas companies be treated under PUHCA similarly to exempt holding companies and other gas companies?

Mr. McClelland:

No, registered gas holding companies will continue to be more tightly regulated than other gas holding companies. This legislation would merely allow PUHCA to be interpreted as permitting registered gas companies to acquire "qualifying cogeneration facilities" which meet rigid FERC standards promulgated pursuant to PURPA. Even then, registered gas companies, although allowed to acquire such "qualifying cogeneration facilities," would still need the SEC's approval of each such cogeneration acquisition and its financing. Moreover, registered gas companies, unlike all other gas companies, will not be permitted to acquire non-qualifying cogeneration facilities.

Chairman:

What has prevented the three registered gas companies from becoming exempt holding companies?

Mr. McClelland:

While I cannot speak for National Fuel Gas and Columbia Gas, I suspect their answers would parallel Consolidated's.

It is Consolidated's ownership of gas distribution companies operating in different states that requires its continued registration under PUHCA. To qualify for an exemption from PUHCA, Consolidated, after obtaining SEC approval, must either dispose of its distribution subsidiaries in one or more of the three states it serves or else undergo a drastic restructuring in order to form a single interstate utility serving all three states. Consolidated has periodically reviewed both options and found them to be unattractive for both its ratepayers and its investors.

Chairman:

Neither of your companies is an exempt holding company, is that correct? What is the difference between a registered holding company and an exempt holding company?

Mr. Currier:

I do not know whether Niagara Mohawk is or is not an exempt holding company. Nonetheless, since S.727 deals exclusively with registered gas holding companies, I would prefer that Mr. McClelland answer this question.

Mr. McClelland:

For a non-lawyer this is a difficult question, but I will seek to plot through it. To begin with, Consolidated is a registered gas holding company as opposed to an exempt gas holding company. A "public utility holding company," as defined in the PUHCA, is any company owning 10% or more of the outstanding voting securities of an electric or gas distribution utility. Unless the SEC otherwise directs, all public utility holding companies are required to register under PUHCA. This involves filing a detailed registration statement reporting the general and financial operations of the company. A registered holding company must comply with PUHCA, of course, and the rules and regulations promulgated under it by the SEC. These restrict the type and nature of a registered company's business activities. A registered company must also file numerous reports and secure advance approval of most matters affecting its financial affairs and the businesses in which it can engage.

An "exempt holding company" is a public utility holding company which has secured an SEC order exempting it from registering under PUHCA. However, the exemption may be withdrawn at the discretion of the SEC. Exemptions are normally granted on the basis that the applying holding company:

Owns one or more public utility companies that largely operate within the boundaries of a single state; or

Is predominately a public utility company whose operations do not extend beyond the state in which it was organized and contiguous states; or

Is only incidentally engaged in the utility business or conducts its utility operations predominately outside the United States.

These exemptions reflect a major purpose of PUHCA, which is to encourage state regulation of utility companies in a holding company system.

Chairman D'Amato:

Will the increased usage of energy produced through cogeneration have an adverse impact on other utilities in the area by eroding their user base?

Mr. Currier:

We feel that cogeneration will in fact help to maintain a viable user base and thus clearly does not have an adverse impact. Consolidated points out that cogeneration development will benefit residential, commercial, and industrial gas consumers. Cogeneration at the same time preserves and enhances the region's electric load. It helps existing industry and that electric load to survive by enabling industry to better meet growing, foreign competition. It can also aid by attracting new industry and jobs -- and their associated electric load -- to the region. Let me give you but one example as to why this is the case. HYDRA-CO and Consolidated recently visited a paper mill in Michigan who has just installed a cogeneration system. They told us flat out that without the cost savings of cogeneration, they would have likely had to go out of business at that plant due to growing foreign competition. The local electric utility still supplies that mill with a portion of its energy need -- although in a more typical cogeneration facility that cogenerated power would have been sold to the electric utility grid. Two hundred jobs are preserved at that mill. Not only are these jobs preserved, but some 300 other indirect jobs in the community and their electric loads are also preserved. In addition, long-term electric loads are preserved at the homes of those 500 employees in the community. This example clearly indicates the importance of cogeneration to other electric consumers in preserving a region's industrial base. Electric consumers also benefit from the system planning flexibility that I discussed in my testimony.

Senator Heinz:

Do you see any direct benefits that could accrue to the electric utility industry from S.727?

Mr. Currier:

We do indeed see a number of benefits from cogeneration. Cogeneration, while not a new concept, was never fully developed in past years because of the economics of central plants. These economics no longer hold, and the efficient use of fuel demands a serious consideration of the development of cogeneration. Cogeneration facilities, economically developed and properly incorporated into the electric network, can reduce financing costs for electric utilities, delay large cash requirements for central plant development, and provide a means for more sensibly matching a varying and somewhat clouded forecast of energy requirements. Cogeneration savings for industry can help preserve and add jobs to the region and thereby maintain electric loads not only at those plants, but also at satellite businesses in the community and in the long-range at the homes of those workers. Maintaining these loads benefits all of the region's energy consumers -- both gas and electric.

Senator Heinz:

You noted that Ohio Valley and New York State cogeneration development could ultimately spend as much as $2.5 billion for specialized cogeneration equipment, services and construction. Can you describe with specificity how those expenditures would benefit Pennsylvania's economy?

Mr. McClelland:

Based on DOE's projections, developing as little as 25 percent of the region's overall cogeneration potential would require purchases of hundreds of millions of dollars of coal/biomass cogeneration equipment and also of gas-fired cogeneration plants. Similar expenditures would also be required for the long-term maintenance and operation at such cogeneration plants. We have looked at a detailed breakdown of these needs and have found Pennsylvania industry and workers to be represented in some fashion in every single one of them. A sampling includes the manufacture of: coal boilers, gas engines, cooling towers, switchgear, pumps, valves, controls, transformers, and of many other components. Also included is the packaging of gas turbine cogeneration assemblies. Additional markets worth tens of millions of dollars would also develop for potential suppliers in the Commonwealth of general maintenance supplies and of piping, structural, and reinforcing steels.

Senator Heinz:

What types of businesses do you anticipate will take advantage of cogeneration?

Mr. Currier:

The principal energy output of an efficient cogeneration plant is thermal. Thus, most industrial cogeneration applications would be in energy using industries such as paper, chemicals, food processing, petroleum, and primary metals. However, industrial cogeneration is applicable to any industrial employer which has a reasonably sized and relatively steady steam load or similar thermal use. Cogeneration is also applicable to hospitals, educational institutions, and commercial business -- all of whom, like industry, will benefit from cogeneration savings.

Senator Heinz:

Can you tell me what Niagara Mohawk, a company not barred from participating in cogeneration, is doing right now to get involved in this technology?

Mr. Currier:

Cogeneration and its development is a viable means of energy supply and provides flexibility to our long-range system planning. Niagara Mohawk's effort is manifested most visibly in HYDRA-CO Enterprises, a wholly owned subsidiary which we created in 1981 to engage in cogeneration and alternative energy production. Three years ago, our HYDRA-CO subsidiary and Consolidated Natural Gas agreed to jointly carry forward the work of developing cogeneration in our region. In this instance we jointly looked at an area not only covering New York State but also Pennsylvania, Ohio, and West Virginia. I can state unequivocally that the expertise of both companies are necessary and proper for the development of cogeneration in the region. The thermal expertise of a gas company such as Consolidated is particularly important in cogeneration application and development. A technical legal issue has thus far grounded this intended partnership and has worked to the detriment of the region's industry being able to secure needed cogeneration savings. This bill, S.727, narrowly addresses this by making the three registered gas holding companies just like all other gas companies with respect to cogeneration development.

Senator Heinz:

You discussed the importance of cogeneration savings for the region's industrial employers and for institutions such as hospitals. Could you tell me how this data translates into potential savings for New York State and describe the role New York State industry could play in supplying the needs of the region's cogeneration development? I am concerned that New York, along with Ohio, Pennsylvania, and West Virginia have missed out on employment gains enjoyed elsewhere.

Mr. Currier:

Niagara Mohawk shares your concern in the fact that the region's growth in jobs lags the rest of the nation. For example, nonagricultural jobs in New York State grew only two percent over the last decade; in comparison, nonagricultural employment in the nation as a whole grew 21 percent. This is important to us as we serve over one-half the land mass in New York State including almost 700 communities. From the studies cited in Consolidated's testimony, cogeneration has the potential to save industry in our state over $200 million each year.

These savings are more than just dollars, they are jobs for the region in such industries as paper, manufacturing, chemicals, and food processing. As an example, a paper mill, Burrows in Little Falls, has submitted a written statement in support of S.727 and the benefits that Consolidated's participation can offer to cogeneration for their mill. In addition to making existing industry more viable, the prospect of third-party cogeneration can also be an important feature in attracting new industry. Both of these goals are of keen importance to us and to the economy of New York State.

Furthermore, HYDRA-CO, our cogeneration subsidiary that would work with Consolidated as a needed partner to develop the region's cogeneration, notes that this would open up a very attractive specialized cogeneration equipment and service market for New York industry. This attractive market would involve New York manufacturers of gas-turbines, steam turbines, packaged engine generators, waste heat recovery boilers, switchgear, transformers, controls, cables, pumps, valves, cooling towers and a host of other equipment and services. Just in these specific areas as reported by Consolidated use DOE estimates, developing as little as 25 percent of the region's cogeneration potential, can provide a regional cogeneration equipment, service, and construction market valued at hundreds of millions of dollars.

Senator Heinz:

You claim potential savings to the region of $1.5 billion from industrial cogeneration. Can you tell me how S.727 would specifically benefit Pennsylvania in terms of industrial energy savings?

Mr. McClelland:

Based on DOE's projections, the application of cogeneration to Pennsylvania industry alone would produce over $700 million of cost savings annually. This includes such key Pennsylvania employers as steel, manufacturing, paper, chemicals, petroleum, and food processing. These types of energy intensive industries employ over 300,000 people in the Commonwealth. To these savings would be added the energy savings of hospitals, educational institutions, and commercial businesses.

Let me give you but one example of how this can work in Pennsylvania: We recently visited a paper mill in another state who has just installed a cogeneration system. They told us flat out that they face growing foreign competition, and that cogeneration savings -- energy is an important cost of their operation -- are critical to that plant's future viability. Not only did cogeneration preserve over 200 jobs at that mill; it also preserved over 300 indirect jobs in the community that relies on that mill as part of its employment. The example of these 500 jobs, preserved in the long-term by cogeneration, typifies how industrial savings from cogeneration can help preserve and enhance Pennsylvania's employment base.

(Above example also used in answer to question posed by Senator D'Amato.)

Senator Heinz:

You indicated that coal would play an important role in the region's cogeneration. Can you explain this potential role for coal in more detail and also why this is of interest to a gas utility?

Mr. McClelland:

Based on DOE data, the primary fuels for Pennsylvania cogeneration facilities will be coal and natural gas, followed by paper mill-type wood waste. As I indicated in my remarks, this could represent a potential 7 million-ton-per-year new, environmentally sound steam coal market, resulting from the development of as little as 25 percent of the region's industrial cogeneration potential. This can help offset a decline in Pennsylvania's industrial use of coal -- for steam plus coking use -- which has fallen from 31 million tons in 1973 to about 12 million tons in 1983.

Third-party cogeneration developers such as Consolidated -- unlike many industrial plants that they would serve -- have the potential capital to fund the greater initial cost of coal boilers and their state-of-the-art pollution controls, including the ability to co-burn gas and coal together so as to obtain the best features of both fuels.

Why should a natural gas company do this:

* First, we recognize that a key factor in cogeneration is to meet the energy user's thermal needs and that coal may be the better fuel in certain applications.
* Second, we are particularly enthusiastic about the ability to co-burn gas and coal so as to most effectively capture the best features of both fuels.
* Thirdly, we recognize that even if we were solely to use coal-fired cogeneration at an industrial facility, the industrial consumer is, in effect, making a long-range commitment to remain in business. Such a customer would most likely have satellite process gas loads which are important to us. Also, industrial and commercial gas loads in supportive

plants and business serving this industrial customer would be kept intact. In addition, we would preserve for the long-term those gas loads at the homes of the workers whose jobs are directly or indirectly related to this industrial plant. Thus, we would still be preserving a major indirect gas load in our region.

Senator Heinz:

What policy reasons are there, if any, to prevent the three registered gas companies from engaging in cogeneration when every other gas utility in the country is free to do so?

Mr. McClelland:

There are no policy reasons to prevent the three registered gas companies from engaging in cogeneration. In our various discussions with public interest groups, legislators, and government officials, no one has ever suggested a single policy reason why these three companies should not be permitted to engage in cogeneration. PUHCA is merely being clarified, not amended.

Senator Heinz:

If S.727 becomes law, how will the SEC's regulation of the three companies change?

Mr. McClelland:

It won't change in any way. The financing or ownership of a proposed cogeneration facility by any of the three companies will still require SEC approval. Their cogeneration activities will remain subject to all of the SEC's rules and regulations under PUHCA and to the SEC's comprehensive financial reporting and accounting procedures in the same manner and extent as all other activities of registered gas holding companies.

BURROWS PAPER CORPORATION

501 E. MAIN ST. - P.O. BOX 987
LITTLE FALLS • NY 13365-0987
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R. W. BURROWS, JR.
PRESIDENT

September 13, 1985

Honorable Alfonse M. D'Amato
Chairman, Subcommittee on Securities
Senate Committee on Banking, Housing, and Urban Affairs
Room 520
Hart Senate Office Building
Washington, D. C. 20510

Dear Chairman D'Amato:

Please consider this letter to be a statement submitted for inclusion in the printed record of the September 17, 1985 Security Subcommittee Hearing regarding S.727. Senate Bill S.727 deserves your active support. The legislation will allow three major gas companies serving New York, among other states, to engage in cogeneration development activities.

As you may know, Burrows Paper Corporation operates three paper mills in New York State and provides jobs for over 200 New Yorkers. Our paper mills are very energy intensive and to remain competitive we are always searching for ways to reduce our energy bills. Cogeneration can affect this reduction.

During the last two years, we have benefited from the thermal engineering and gas industry expertise of Consolidated Natural Gas, one of the three companies affected by this legislation. While helping us to assess the benefits of cogeneration at our Little Falls, New York mill, they developed an innovative approach that recovers additional thermal energy from the cogeneration process for use in our paper dryers.

We have recently committed to a third-party financed cogeneration project to supply energy to one of our Little Falls paper mills. This arrangement results in important energy cost savings. We are reserving a limited equity position for Consolidated in the proposed cogeneration plant. This is because we believe Consolidated would be a most suitable owner and operator of our cogeneration facility. Their representatives have impressed us with their thermal knowledge and their grasp of cogeneration in general. With the passage of S. 727, Consolidated will be able to exercise this option and become more active in our project's development.

Consolidated could add to the development of cogeneration throughout the State of New York. This would be helpful for other large energy consumers.

Very respectfully,

BURROWS PAPER CORPORATION

RWB/jg

R. W. Burrows, Jr.

54-686 0 - 86 - 3

Statement of

John G. L. Cabot
President

Cabot Corporation

Mr. Chairman and Members of the Committee:

I am pleased to make this statement on behalf of Cabot Corporation in support of a noncontroversial amendment to the Public Utility Holding Company Act of 1935. As Senior Vice President of Cabot Corporation, I am responsible for the overall operation, profitability and return on investment of that company's Energy Group.

From the outset, let me say that Cabot Corporation is uniquely affected within the natural gas industry by the 35 Act. Our purpose today, as it was in our testimony before this Subcommittee on June 10, 1982 and June 15, 1983, is to seek support for an amendment to the 35 Act which will permit us to operate in the most efficient, effective manner possible. In doing so, the ultimate beneficiaries will be the stockholders, who will benefit from a greater return on equity, and the consumers who should enjoy lower rates in the long run.

Cabot Corporation

Cabot Corporation ("Cabot") was founded a little over 100 years ago. It is a Boston-based manufacturer with annual sales of approximately $2.1 billion. Our businesses include energy, specialty metals and performance chemicals.

In the Energy Group, Cabot explores for and produces crude oil and natural gas, operates gas processing plants, natural gas pipelines and a distribution system, and imports and sells liquefied natural gas (LNG).

In the Engineered Products Group, we produce and sell specialty metals, alloys, compounds and materials for use in the aerospace, chemical processing, nuclear, paper, pollution control, aluminum and electronics industries. Energy absorbing resins and noise control products are also manufactured by this group.

In the Performance Chemicals Group, Cabot is the leading worldwide producer of carbon black, a chemical used primarily as a reinforcing agent in rubber tires, and is the largest domestic producer of fumed silica, used principally as a reinforcing agent in silicone rubber and as a thickening agent in liquids.

Cabot's Natural Gas Utility in West Virginia

A small part of Cabot's business is a state-regulated natural gas utility which operates in West Virginia as a division of Cabot. In calendar year 1984, Cabot utility revenues of $21.7 million represented 1.2 percent of Cabot's consolidated worldwide sales. Being approximately 99 percent non-utility puts us at the extreme end of the range of companies that have both utility and non-utility interests.

Cabot entered the utility business quite by accident. In the late 1800s and early 1900s, the company explored for and produced natural gas in West Virginia and Pennsylvania to supply its carbon black manufacturing operations. The company permitted rural West Virginians to purchase excess gas supplies from Cabot's pipelines. These sales became regulated as state and federal utility regulations evolved. The Cabot utility is

currently regulated by the West Virginia Public Service Commission, and Cabot Corporation is subject to the panoply of Federal securities, energy regulatory and other statutes.

Our West Virginia utility serves approximately 23,000 residential, commercial, small industrial and sales-for-resale customers in sixteen counties, and in recent years, annual gas sales to residental, commercial and small industrial customers aggregated approximately 4-percent of the total of such gas sales by value by all public utilities in West Virginia. In 1984, the utility delivered approximately 3.6 bcf of gas to residential and commercial customers, 2.9 bcf to sales-for-resale customers in transactions regulated by the PSC, and about 1.3 bcf under special contract to a small number of large industrial customers.

The Unnecessary Problems of Operating a Public Utility within a Diversified Corporation

Cabot has experienced outstanding growth in recent years. In short, we have managed successfully not only a utility business, but also a diversified business. As to the former, over the last decade we have had both the lowest retail gas rates of any major West Virginia utility and, generally, a better record of gas availability.

Even though we have been a success in both utility and non-utility businesses, the 35 Act places a severe burden on Cabot's organization. Cabot is not like the registered public utility holding companies which seek amendments to the 35 Act in order to begin diversification. Cabot is at the other end of the

spectrum. It wishes to reorganize the corporate structure of its West Virginia natural gas utility operation by constituting a wholly-owned subsidiary corporation from its present division.

Let me be more specific.

A utility has special regulatory requirements which argue for separating utility operations from other businesses within the overall corporate structure. The logical way for Cabot to do this would be to operate its West Virginia utility as a subsidiary. The Securities and Exchange Commission has informed Cabot that it cannot grant the desired exemption from the 35 Act to Cabot Corporation in the absence of an amendment to that Act. Thus, Cabot has been forced to operate its utility business within the parent company.

If we were to place our utility business in a subsidiary under the present law, the parent company would become its holding company and have to register as such under the 35 Act. As such, we would then have to divest all businesses not "reasonably incidental" to our utility business. Astonishingly, this means we would have to divest ourselves of our nearly 99 percent of non-utility businesses in order to keep the one percent -plus utility business or, in the alternative, sell the utility in order to avoid such sale of the non-utility businesses. Neither is desirable for Cabot, its shareholders, the utility, its customers or the public.

As a result, Cabot, being forced to operate its utility as a division, rather than as a wholly-owned subsidiary, with the entire parent company as the utility of record in West Virginia,

suffers under inefficiencies which burden the corporation, its utility, its customers, and even the PSC. In past proceedings before the West Virginia Public Service Commission, neither that Commission nor Cabot has been able to define satisfactorily what the utility is in terms of assets, debt and equity or liability for taxes, which makes ratemaking an uncertain procedure at best.

If the amendment proposed were enacted, Cabot could operate the utility as a subsidiary. It makes a great deal of sense to do that. For one thing, the utility would be a well-defined separate corporate entity with known assets, debt and equity and taxes, with the flexibility to assume a typical utility industry debt structure. Generally, utility industries are characterized by more favorable debt to equity ratios, which have historically reduced the cost of capital to utilities. For another thing, a utility operated as a subsidiary is easier to manage. It requires an inordinate and otherwise distinct amount of time to manage an operation not sufficiently distinct within an overall corporate structure.

Cabot Corporation and the SEC

At the time of the enactment of the 35 Act, Cabot's utility gas distribution system in West Virginia was conducted by Cabot's predecessor, Godfrey L. Cabot, Inc., a Massachusetts corporation, through a wholly-owned subsidiary, the Wak Company, a West Virginia corporation. In Godfrey L. Cabot, Inc., 3 SEC 273 (1938), Godfrey L. Cabot, Inc.,Cabot Corporation's principal predecessor organization, applied for an exemption from the Act

under section 3 (a)(3) thereof. The SEC approved the exemption application on the basis that Godfrey L. Cabot, Inc. was only incidentally a holding company, being primarily engaged in businesses other than the business of a public utility company and not deriving any material part of its income from the public utility business.

While the SEC has never formally withdrawn that exemption, it has less formally been understood that Cabot Corporation, successor since 1960 to Godfrey L. Cabot, Inc., would not be qualified for the exemption if it reorganized its West Virginia natural gas utility as a subsidiary. In 1980, counsel for Cabot Corporation drafted an application for exemption from the 35 Act and discussed that application with the SEC staff, after which counsel was informed that, if the application were filed formally, exemption, granted solely on the basis that the application was pending, could be granted. In light of the provisions of the 35 Act and its enforcement history, such a "pendency exemption" alone would be inadequate, exposing Cabot Corporation to potentially substantial legal, economic and practical risks. In a staff level meeting with Cabot and its counsel on April 3d, 1985, the SEC staff confirmed that the only effective remedy would be amendment to the 35 Act.

Cabot Corporation and Recent Congressional Deliberations

Cabot Corporation testified at the 1982 Senate hearings, and submitted statements at the 1983 Senate and 1983 House hearings.

The Cabot position was made widely known among interested

Senatorial and Congressional committee, subcommittee, and legislative members and staff; within the SEC; among the trade associations favoring, and those opposing, repeal or majoramendment; within the utility industries; within the National Association of Regulatory Utility Commissioners; within the Administration; and among witnesses generally at such hearings.

No one is known to Cabot Corporation to have opposed the amendment sought to exempt Cabot Corporation from the 35 Act. The so-called Cabot Amendment was not enacted because the broader legislation of which it was a part was not enacted.

S. 727 and Cabot Corporation

The only reasonable prospect for amendment to the 35 Act during the 99th Congress appears to us to be through the Committee's attention to S. 727, introduced on March 20 of this year by Senator Heinz, a bill to clarify the application of the 35 Act to encourage cogeneration activities by utility holding company systems. We support S. 727 and encourage its enactment.

S. 727 is, to our knowledge, non-controversial. So, too, is the amendment which we seek. Even though it is of profound importance to Cabot Corporation, for the rest of the world it is a simple issue: one amendment required to address a situation not foreseen by the 35 Act, the case of an almost totally diversified non-utility company operating a small utility operation established many years prior to the 35 Act and, therefore, not in contemplation of it. The amendment sought is,

quite frankly, a technical one. Our proposed amendment to the 35 Act is as follows:

At section 3(a) of the Public Utility Holding Company Act of 1935 -

(1) strike the word "or" at the end of paragraph (4);

(2) strike the period at the end of paragraph (5) and inset in lieu thereof a semicolon and the word "or"; and

(3) add the following new paragraph:

"(6) such holding company has only one subsidiary company which is a natural gas public-utility, the operations of such subsidiary company as such do not extend beyond the State in which that subsidiary company is organized and States contiguous thereto, and neither the holding company nor the subsidiary company is engaged in retail residential or commercial plumbing, heating, or electrical, air conditioning or related equipment installation or servicing."

If this amendment, which is an improvement on the amendment pending in 1982 and 1983, is enacted into law, Cabot Corporation could reorganize its West Virginia natural gas utility division into a wholly-owned subsidiary corporation. Cabot Corporation, as a holding company, would then have only one subsidiary company

which is a natural gas public utility, as defined by the 35 Act, and that subsidiary company's operations, as such, would not extend beyond West Virginia, in which it would be organized, and the States contiguous thereto. Neither Cabot Corporation nor the wholly-owned subsidiary company engages now, nor would it engage then, in retail residential or commercial plumbing, heating, electrical, air conditioning or related installation or servicing. This latter matter was an issue at the 1982 and 1983 hearings; our language removes it as an issue.

It is clear to us that if Cabot Corporation reorganized its West Virginia natural gas utility operations into a subsidiary corporation and met the requirements of this new language, the provisions of amended section 3(a) would govern, and that the Securities and Exchange Commission, by rules and regulations upon its own motion or by order upon application, would unconditionally exempt Cabot Corporation from the 35 Act.

We believe, further, that "unconditionally" refers, first, to the SEC following the mandate of Congress in enacting the additional exemption, i.e., the SEC will not exercise some authority to preclude the exemption, and, second, to the SEC not attaching conditions to the exemption.

We hope that the Congress will send to the President's desk both the amendments to the 35 Act set forth in S. 727 and in our proposed amendment.

Cogeneration Coalition Of America, Inc.
2 Lafayette Centre
1133 21st Street, N.W.
Suite 500
Washington, D.C. 20036
Phone (202) 887-5200

September 25, 1985

The Honorable Alfonse D'Amato
U.S. Senate
Room 520
Senate Hart Office Building
Washington, DC 20510

Dear Senator D'Amato:

On behalf of the membership of the Cogeneration Coalition of America, Inc., we respectfully submit the enclosed written statement for the record in support of S. 727. This matter was the subject of hearings before your Subcommittee on September 17, 1985.

The Cogeneration Coalition thanks you for your interest in correcting the historical anomaly which is addressed by S. 727, and your recent support as a cosponsor. We urge you to do whatever is necessary to assure prompt mark-up of this bill, which would remove a substantial federal regulatory impediment to cogeneration development in an important region of our country.

If we can provide further information or assistance, please do not hesitate to contact our staff further.

Sincerely yours,

Richard R. Stewart
President

RRS/la
Enclosure

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1133 21st Street, N.W.
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Written Statement
For Submission to the Hearing Record
Of September 17, 1985
Before the
Subcommittee on Securities
of the
Senate Committee on Banking, Housing and Urban Affairs

The following written statement for the record is filed on behalf of the Cogeneration Coalition of America, Inc. (Coalition), in support of S. 727, which would clarify the applicability of the Public Utility Holding Company Act to registered natural gas companies.

The Coalition is comprised of interested natural gas and electric utilities, equipment manufacturers, commercial and industrial energy users, and engineering design and development companies which support the development of cogeneration potential nationwide. The Coalition was formed in 1980, and is dedicated to the removal of unnecessarily restrictive Federal barriers to the growth and development of cogeneration nationwide, as well as to the provision of necessary tax and financial policies in support of cogeneration.

The problem which S. 727 is devised to correct is exactly the type of unnecessarily restrictive Federal impediment to cogeneration development which the Coalition has focused upon since its inception. S. 727 would remove this restriction in a freestanding manner, without amending either the Public Utility

Regulatory Policies Act of 1978 or the Public Utility Holding Company Act of 1935. This necessary clarification would remove the technical uncertainty now before the Securities and Exchange Commission regarding the ability of registered gas companies to own and develop cogeneration facilities. This impediment to the three remaining registered gas companies appears to have evolved as a historical anomaly, and demands current and expeditious consideration by this Committee to permit achievement of cogeneration potential in New York and the Ohio Valley.

The potential for cogeneration development in this region has been discussed in various independent studies, including those conducted by Frost and Sullivan, the Department of Energy, and the Federal Energy Regulatory Commission. However, the region's ability to achieve fuller penetration of this capability has been restricted for a variety of reasons. The three remaining registered gas companies could provide a strong and useful capability in these areas to promote greater third-party development of cogeneration for industrial and commercial energy users. S. 727 is specifically designed to foster this development in the future.

Cogeneration development would make available important employment, economic, and manufacturing benefits to companies within this region. Furthermore, the growth of cogeneration in this region on a basis which is more consistent with national growth patterns could provide important consumer and

ratepayer benefits. Some of these benefits relate to the fact that cogeneration facilities can be constructed at an accelerated pace compared to the time it takes utilities to plan and build traditional generation stations. With accelerated construction, the financial situation of electric utilities could be improved because of a reduction in capital requirements. Furthermore, new capital markets could be provided for the development of electric generation projects from such third-party resources.

No subsidization by ratepayers with respect to cogeneration development would occur since the rate paid for such power would be no higher than it would have cost the electric utility to generate the same unit of energy for its own ratepayers. Moreover, in many instances, cogeneration projects do not sell electric energy back to the electric utility at all. As a sufficient number of cogeneration and small power production facilities on a specific system increase in time, the marginal fuel for that system will cease to be strictly oil or natural gas. Moreover, an increase in dispersed generation sources can improve air quality and yield reduced environmental costs of compliance for the electric utility and its ratepayers.

For the foregoing reasons, the Coalition supports prompt enactment of S. 727, as consistent with sound national energy policy. This legislation, which is crafted as a technical clarification of the Public Utility Holding Company Act, appears to be noncontroversial, and commands prompt attention

for expeditious enactment. On behalf of our membership, we respectfully request that this written statement be included as part of the formal hearing record on S. 727 established by the Subcommittee on Securities on September 17, 1985.

CONSOLIDATED NATURAL GAS COMPANY
Four Gateway Center
Pittsburgh, Pennsylvania 15222

(412) 227-1000

September 18, 1985

The Honorable Alfonse D'Amato, Chairman
Subcommittee on Securities
Senate Committee on Banking, Housing
and Urban Affairs
541 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator D'Amato:

We would like to thank you for your invitation to testify before the Subcommittee at the hearing yesterday regarding S.727. As Consolidated's testimony stated, the bill would provide the three registered gas companies with the opportunity to participate in cogeneration activities on the same basis as the nation's other gas companies.

As you know, we had hoped to have the opportunity to appear before the Subcommittee personally and regret that irreconcilable scheduling conflicts prevented this. Nevertheless, you may be assured that each of us is keenly interested in this matter and is firmly supportive of Dick McClelland, General Manager of CNG Energy Company, a wholly owned non-utility subsidiary of Consolidated, who testified on our behalf at yesterday's hearing.

We appreciate your willingness to hold a hearing on S.727, we thank you for your consideration of the bill, and we look forward to timely Committee action. Also, we would like to express particular appreciation for the efforts of Tom Lykos,

who has been unfailingly courteous, helpful and insightful on this issue since his recent appointment as Counsel to the Subcommittee.

Sincerely,

Jack Tankersley

G. J. Tankersley
Chairman and Chief Executive Officer

Ralbern H. Murray

Ralbern H. Murray
President and Chief Operating Officer

FAIRMONT GENERAL HOSPITAL
FAIRMONT, WEST VIRGINIA 26554
304/367-7100

September 13, 1985

Honorable Alfonse M. D'Amato
Chairman, Subcommittee on Securities
Senate Committee on Banking, Housing & Urban Affairs
Room 520
Hart Senate Office Building
Washington, D.C. 20510

Dear Chairman D'Amato:

Please consider this letter to be a statement submitted for inclusion in the printed record of the September 17, 1985 Securities Subcommittee Hearing regarding SB-727.

Like many other hospital administrators nationwide I spend a considerable amount of time and effort to limit the rising cost of health care and for this reason I am writing to you to urge your support of Senate Bill S.727 to encourage cogeneration activities by gas utility holding company systems.

In recent discussions with officials of Hope Gas, a subsidiary of Consolidated National Gas Service Company, it was brought to my attention that a cogeneration bill was introduced and that considerable savings could be realized by hospitals if the bill was passed. As you no doubt are aware energy costs represents a considerable amount of a hospital's costs and the potential savings of cogeneration could contribute significantly in our attempts to reduce energy expense.

Historically, Hope Gas has given us considerable support in our attempts to reduce energy costs, and their knowledge of cogeneration will be of great benefit to our energy conservation efforts.

Your support for Senate Bill S.727 will be greatly appreciated.

Sincerely,

Robert M. Ptomey
Administrator

RMP:mbe

WRITTEN STATEMENT FOR THE RECORD
OF NATIONAL FUEL GAS COMPANY

SUBCOMMITTEE ON SECURITIES
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
SEPTEMBER 17, 1985

National Fuel is pleased to submit a written statement for inclusion in the hearing record regarding S. 727. Our interest in the bill is attributable to the impact of S. 727 on the three remaining gas utility holding companies still registered under the Public Utility Holding Company Act of 1935 (PUHCA); National Fuel is one of these three companies. Because of the status we share, National Fuel, Consolidated and Columbia are the only gas companies in the country presently barred from investing in, acquiring, or retaining an interest in cogeneration facilities. S. 727 would alleviate this anomaly by clarifying and making consistent the congressional intent of PUHCA and the Public Utility Regulatory Policies Act of 1978 (PURPA). We join Consolidated Natural Gas, which is testifying orally on our behalf today, in full support of S. 727.

National Fuel Gas Company is a holding company engaged only in the business of owning and holding all of the securities of five subsidiaries. These subsidiaries are involved in every aspect of the natural gas business: exploration, production, purchasing, gathering, transmission, storage and distribution. Our primary retail business areas are in Western New York, Northwestern Pennsylvania and Eastern Ohio. Our largest subsidiary is National Fuel Gas Distribution Corporation (Distribution) which serves gas to over 672,000 customers in these areas.

Distribution has experienced a substantial decline in sales over the past five years. We believe this was not only attributable to conservation, industrial use of alternative fuels and cutbacks due to the recession but most notably from numerous plant closings. We suspect that if these businesses had had the opportunity to reduce their energy costs by at least 15 to 18 percent through the use of cogeneration facilities, many could have survived. If S. 727 is enacted, National Fuel is confident that it can help deter further industrial deterioration in the Northeast and, in fact, attract new business to the area.

A renewed national interest in cogeneration has evolved over the past decade due to the dramatic rise in fuel and electricity prices, regional electrical capacity restraints and a desire for protection from fuel shortages. It has also become part of an effort to develop alternative energy sources to reduce U.S. dependence on imported oil and nuclear power.

Congress recognized the value of cogeneration in 1978 when it enacted the Public Utility Regulatory Policies Act (PURPA). This legislation was intended to revive the use of cogeneration as a means of fostering cheaper and more efficient generation of power. As a result, most regions in the United States are working vigorously to achieve their cogeneration potential with the exception of the Northeast.

Unfortunately, most industries in the Northeast are not investing in cogeneration because their first order of business is to improve and modernize aging plants. They tend to lack the necessary capital, as well as the expertise in the field, and are deterred by confusing government regulations at the fed-

eral, state and local levels. In addition, electric utilities have not demonstrated any interest in owning and operating cogeneration facilities; private investors are more attracted to cogeneration projects in higher growth areas; and many gas utilities serving the Northeast are not large enough financially to take on the major cogeneration plants needed by heavy industry.

However, the most glaring reason why the Northeast has not achieved its cogeneration potential is that the only three business entities in the United States which are legally barred from an involvement in cogeneration are the most likely candidates to bring cogeneration into the industrial areas of the Northeast. These three companies--National Fuel, Consolidated and Columbia--have the financial resources, the expertise and the desire to help local businesses remain viable by reducing their overall energy costs through cogeneration. While the Securities and Exchange Commission (SEC) apparently does not object in principle to the ownership and operation of cogeneration facilities by the three registered gas utility holding companies, it is apparently concerned about the legal interpretation of PUHCA Section 11(b)(1) which permits registered gas companies to become involved in only "functionally related activities."

The purpose of S. 727 is simply to clarify that cogeneration meets this functional relationship test, thereby making consistent the congressional intent of PURPA with PUHCA. National Fuel, Consolidated and Columbia could then be treated like any other company in the United States in their ability to invest, acquire or retain an interest in any qualifying cogeneration facility as defined by PURPA. In addition, businesses in New York, Pennsylvania, Ohio and

West Virginia could finally possess the very same flexibilities enjoyed by business in every other state of the union since the passage of PURPA in 1978.

The original purpose of PUHCA was to halt abuses by the utility industry caused by complex corporate structures and questionable securities and accounting transactions. S. 727 would not tamper with this purpose nor would it alter the SEC's general regulatory jurisdiction over the three companies or its comprehensive financial and reporting requirements.

In 1935, when PUHCA was enacted, Congress could not foresee the energy problems which would arise in the 1970's and 1980's nor the new developments in the energy industry. PURPA addresses these more recent needs. The original purpose of PURPA has been hampered to date by a narrow and outdated interpretation of PUHCA. S. 727 would simply eliminate this inequity without changing the language of either PUHCA or PURPA and without affecting any other existing legislation.

We are confident that the enactment of S. 727 would lead to the increased use of cogeneration. National Fuel's marketing department has discovered a growing interest among our industrial and commercial customers to secure our financial and other support to build cogeneration facilities. These customers recognize that cogeneration offers them the potential to experience reduced energy costs, increased productivity and/or profits due to reduced system capital costs as well as enhanced energy security.

Our primary cogeneration candidates are those energy consumers who wish to offset a more expensive fuel and who exhibit constant energy consumption over time so that the cogeneration facility can operate more efficiently and supply a higher proportion of annual energy needs. These are predominantly manufacturing plants (chemical, steel, paper and food), hospitals and educational facilities.

If S. 727 is enacted and if the SEC provides its approval, National Fuel and the other two registered gas companies could decide to do any of the following:

(1) Set up a subsidiary to act as a lending institution for cogeneration projects;

(2) Enter joint ventures with energy consumers with or without the participation of other investors;

(3) Finance an entire cogeneration investment, then lease the equipment to the cogenerator with an option to purchase the equipment at the end of the lease;

(4) Form a subsidiary to own cogeneration equipment and charge the consumer for the thermal energy (heat, gases or steam) produced plus a lease payment on the equipment.

Beyond the specific energy consumers who would invest in cogeneration, there would be many other beneficiaries. For example, all of National Fuel's ratepayers would experience a mitigating effect on their gas rates. Curbing commercial and industrial load loss with new gas-fired cogeneration facilities would allow National Fuel's fixed costs of operation to be spread over a wider sales base, thereby helping to contain gas rates. In addition, because cogen-

eration customers are not particularly sensitive to variances in weather, the reduced fluctuations in gas demand would result in the more efficient utilization of our pipeline system and would have a further stabilizing effect on gas rates.

On a broader scale, the general advantages to the Northeast include energy conservation and the more efficient use of energy resources. A Department of Energy-sponsored study calculated that cogeneration will produce at least a 15 to 18 percent energy conservation potential for the five major energy-consuming industries. In addition, about two-thirds of the energy consumed by conventional electric power plants is vented into the atmosphere or discharged into our waterways, and cogeneration technology would minimize such waste.

Another general advantage to the area would be the reduction in environmental pollution. Gas-fueled cogeneration systems emit less than one percent of the SO_x, 27% of the particulates and 50% of the NO_x produced by comparably sized conventional coal and oil based systems with pollution control equipment.

The most exciting advantage to the Northeast is the potential for improved business vitality and economic growth. This is very important to National Fuel because we cannot transport our operations elsewhere; our utility company will flourish or deteriorate along with the economy of the area we serve. We are confident that the reduction in energy costs for businesses as a result of cogeneration could provide our area with the necessary stimulus for economic recovery with accompanying employment opportunities.

Since the Northeast stands to gain substantially from cogeneration with respect to reduced energy costs, industrial revival, productivity, jobs, energy conservation and environmental protection, this region should be given a chance to share in the benefits which cogeneration offers along with the rest of the nation. In order to best accomplish this and to fulfill the congressional intent of the Public Utilities Regulatory Policies Act of 1978, a minor clarification of congressional intent regarding Sec. 11(b)(1) of the Public Utility Holding Company Act of 1935 is necessary. National Fuel accordingly urges your support for this proposed noncontroversial bill, S. 727.

PREMIX, INC.
P.O. BOX 886 ASHTABULA, OHIO
44004

GEORGE H. KAULL
CHAIRMAN
CHIEF EXECUTIVE OFFICER

September 13, 1985

The Honorable Alfonse D'Amato
Chairman, Subcommittee on Securities
Senate Committee on Banking, Housing and Urban Affairs
Room 520
Hart Senate Office Building
Washington, DC 20510

Dear Chairman D'Amato:

Please consider this letter to be a statement submitted for inclusion in the printed record of the September 17, 1985, Securities Subcommittee hearing regarding S.727.

Premix, Inc., manufactures fiberglass reinforced compounds and customer compression molded parts. Our products are used for autos, housing, and personal computers. We have two manufacturing plants in Eastern Ohio, close to Cleveland, each employing over 500 persons. Like many in this region, we have been concerned with recent incursion of low priced foreign products just as industry in the Northeast has been coming out of the recession. In order for industries in this region to be competitive, it is necessary for them to institute operational cost savings and, thus, lowering prices of their products.

Cogeneration is a proven technology that can reduce an industry's energy costs. We are aware that many industries in Eastern Ohio have been contemplating installation of such facilities at their plants. However, we are also aware that other companies are interested in cogeneration but simply do not have the capital to invest in these projects. Consequently, they will benefit from a cogeneration application only if another outside party is willing to own and operate such a system and sell the energy to them. Unfortunately, we have not seen in Ohio any significant third-party activity in the regard.

It is all the more disturbing, therefore, that a company like Consolidated Gas, which is the major gas supplier to Eastern Ohio and desires to be a full service cogeneration developer, is precluded from doing so because of legal restrictions within the Public Utility Holding Company Act. We obtain natural gas for our thermal process needs from East Ohio Gas Company, a subsidiary of Consolidated. Our knowledge of Consolidated through our relationship to East Ohio Gas convinces us that they have the commitment,

technical and regulatory skills, and the financial backing necessary for successful cogeneration project development.

Consequently, I want to strongly urge you and your Subcommittee to support this bill and to recommend its passage in the Senate.

Yours truly,

George H. Kaull

George H. Kaull
Chairman and C.E.O.

bw

they compete with each other to serve as funding media for employees' pension or profit-sharing plans."[12] Insurance companies, which do not exercise trust powers,[13] would have a competitive advantage over banks if banks are not permitted to manage in such collective trusts fund assets of section 401 trusts of which they are "managing agents" as this term is currently used in Regulation 9.18. This would be directly contrary to the Congressional intent.

In view of all the foregoing, we would not recommend that the Commission take any enforcement action under the 1940 Act if the First National Bank of Birmingham ("Bank") proceeds in the manner described in your letter without registering its Collective Trust under the 1940 Act in reliance on section 3(c)(11) of the Act.

The Division of Corporation Finance has asked us to advise you that on the basis of the facts presented in your letter and in a telephone conversation with the staff, it will not recommend any enforcement action to the Commission if the Bank, in reliance upon your opinion as counsel that the Section 3(a)(2) exemption is available, implements and operates the Collective Trust in the manner described without compliance with the registration provisions of the Securities Act of 1933.

[¶ 77,328] Consolidated Natural Gas Service Company.

Securities and Exchange Commission, Division of Corporate Regulation. October 27, 1982. (Available December 17, 1982.) Correspondence in full text.

Holding Companies—Acquisitions—Functional Relationship.—A registered gas utility holding company could not acquire a 50% interest in a non-utility business whose primary purpose would be to produce electric energy through cogeneration projects. Although the gas holding company stated it would provide the natural gas used to fuel the projects—facilities, the acquisition could not satisfy the functional relationship test of Section 11(b)(1) of the Holding Company Act, which requires that the acquisition be "reasonably incidental" or "economically necessary" to the operations of the utility system. There is no functional relationship simply because the acquired company will purchase energy from the utility company. Further, federal policy favoring cogeneration projects may help satisfy the "public interest" test of Section 11(b)(1), but the functional relationship standard is a separate statutory test. Finally, the Section 9(c)(3) exemption for acquisition of "commercial paper and other securities" was not available since that exemption pertains to limited investments and not to acquisitions resulting in control.

See ¶ 36,801, 36,821, "Holding Companies—Registration; Acquisitions" division; and ¶ 37,061, "Holding Companies—Simplification of Systems" division, Volume 4.

[*Letter of Inquiry*]

At our meeting in Washington on June 24th, you requested we provide you a letter substantiating under the Public Utility Holding Company Act of 1935 the participation of CNG Energy Company, Consolidated Natural Gas Company's wholly-owned subsidiary, in the business of designing, constructing and operating cogeneration facilities, deemed to be qualifying facilities within the meaning of Section 201 of the Public Utility Regulatory Policies Act of 1979 ("PURPA").

I. *Summary*

The "energy crisis" not only continues to threaten the nation, particularly with respect to its national security and economy, but also continues to devastate gas utility markets. Cogeneration opens up badly needed gas marketing opportunities for Consolidated while at the same time allowing it to add its efforts in helping solve our national energy problems. PURPA and other legislation plainly confirm the high importance Congress attaches to cogeneration as part of its energy program. Cogeneration is a natural fit with gas utilities and the Government has clearly encouraged their participation.

Cogeneration is related to Consolidated's utility operations in a number of

12. H.R.Rep. No. 1382, 91st Cong., 2d Sess. 18 (1970); S.Rep. No. 184, 91st Cong., 1st Sess. 23 (1969); S. Rep. 1351, 90th Cong. 2d Sess. 30 (1968).

13. *See generally*, 43 Am Jur 2d, Insurance §§94-95.

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ways. Most importantly, it offers Consolidated a means to help industry make more efficient use of natural gas (reducing the ultimate cost of energy) and thereby enabling Consolidated to revitalize its suffering gas markets. Moreover, there can be little question that Consolidated's investors and consumers will derive substantial benefits from Consolidated's participation in cogeneration and that the public will be greatly served.

Legal precedent, in our opinion, supports finding a "functional relationship" between cogeneration and Consolidated's utility operations. Alternatively, because of the serious national concerns involved, we request the Division to exempt Consolidated's proposed cogeneration activity from the need of approval by employing Section 9(c)(3) of the Act.

II. *Description of Projects Contemplated*

To this point, we have been involved in serious negotiations only with two potential cogeneration customers (Companies "A" and "B") both industrial manufacturers located in the State of New York.

Company "A" would require a gas-fired cogeneration plant on the order of 20 megawatts or more in capacity. It will employ a gas combustion turbine with a waste heat boiler. The gas load for the cogeneration plant could approximate 3.1 Bcf per year, the exact volume depending upon the size and the system that is ultimately selected. Natural gas would be sold to the plant by the local utility, Syracuse Suburban Gas Company. The gas would be supplied by the Consolidated System via Niagara Mohawk Power Company, Consolidated's major wholesale customer. The electricity generated by the cogeneration plant would be purchased by Niagara Mohawk. The total cost of the plant is estimated at $25 million. We envision project financing in a range of 65 to 75 percent debt, which would not be included on Consolidated's balance sheet. The equity portion of the investment would be contributed by The Cogent Energy Company ("Cogent"), an equal partnership of CNG Energy Company and Hydra-Co Enterprises, Inc., a wholly-owned subsidiary of Niagara Mohawk. Thus, CNG Energy's equity investment in the project is currently estimated at $4 million which equals 0.36% of Consolidated's year-end 1981 equity capitalization. Cogent would own and operate the cogeneration plant and sell steam to Company "A" under a long-term contract. Cogent would share in the benefit derived from selling byproduct electricity produced from the plant to Niagara Mohawk. Rates for the sale of electricity under PURPA are required to be "just and reasonable" and may not exceed Niagara Mohawk's avoided cost of power.

Company "B" is interested in a coal-fired cogeneration plant of 10 megawatts capacity, using a stoker boiler with a steam turbine. The total cost of the cogeneration plant is estimated at $35 million. The higher capital cost of this plant stems from its use of coal. Again, Company "B" would purchase the steam, Niagara Mohawk would purchase the power output at PURPA mandated rates, and Cogent would anticipate obtaining project financing between 65 and 75 percent debt. CNG Energy's share of the Cogent partnership's equity investment in the project is estimated at $5 million.

The projected rate of return on our equity investment in both these projects has been calculated at no less than 25% which is double that currently allowed us by the Federal Energy Regulatory Commission ("FERC"). The risks associated with these investments will rest entirely with Consolidated's shareholders.

We are presently talking with a number of other prospective cogeneration customers in all states in which the Consolidated System presently operates. While none of these have reached the negotiating stage as yet, it is contemplated that the business arrangement we enter into with any of them would parallel the approach just described.

In instances where natural gas is not used as a primary fuel there are opportunities under PURPA to use natural gas for fuel stabilization, ignition, supplemental firing or similar uses. Coal and natural gas mixtures may be a particularly effective and clean fuel source for small size boilers in cogenerstion systems. One-quarter of a large industrial load is better than no load.

During the embarkation of Cogent, it would simply not be economically feasible for CNG Energy Company to restrict its involvement in cogeneration wholly to natural gas applications. The separate staff and facilities that will be required, in order to engage in the cogeneration business, could not be profitably maintained if its marketing opportunities were so limited. A full staff in such situation would be operating a partial business. However, this would not be the case after the next few years whenever our cogeneration operation becomes established. It is our present intent at such point to restrict our involvement in cogeneration to installations using natural gas as a fuel source.

III. *PUHCA Standards for Approval of Proposed Cogeneration Activity as Last Pronounced*

a) *Sections 9, 10 & 11.* The acquisition by Consolidated of stock of its newly-formed wholly-owned subsidiary, CNG Energy Company, relative to a Cogent project normally requires, by virtue of Section 9(a)(1), approval of the Commission under Section 10 (The one exception involves an acquisition exempted from approval under Section 9(c)(3)). Section 10 then contains five general standards, at least two of which — 10(b)(2) and 10 (c)(2) — are clearly inapplicable to acquisitions of non-utility interests. A third — 10(b)(1) — provides, in brief, that the acquisition must not tend towards interlocking relations or concentrations of control of utility companies. This acquisition cannot so tend since, under PURPA, Cogent is clearly not a utility. The fourth — 10(b)(3) — provides that the Commission shall approve the acquisition unless it finds that the acquisition will unduly complicate the capital structure of the applicants (this acquisition clearly will not) or will be detrimental to the public interest or the interest of investors or consumers or the proper functioning of the applicant's system. Finally, under Section 10(c)(1), as here pertinent, notwithstanding that the foregoing standards may all be satisfied, the acquisition may not be "detrimental to the carrying out" of the provisions of Section 11.

b) *Michigan Decision.* While a number of proposed acquisitions have no doubt been reviewed by the Commission since the *Michigan* decision[1] in 1971, we can find no Commission orders discussing the Section 11 standards to any serious extent.

Michigan represented the first testing of the non-utility acquisition provisions of the Act in almost twenty-five years. In *Michigan*, the Court of Appeals for the District of Columbia Circuit held that the Commission correctly denied the utility the authority to make further investments in a wholly-owned subsidiary organized to build and operate federally assisted, low and moderate income housing projects in blighted areas of metropolitan Detroit. The Court affirmed the Commission's position that Sections 9, 10 and 11 of the Act impose a two-step "functional relationship" test, requiring that the applicant show first that the proposed acquisition is "reasonably incidental, or economically necessary or appropriate to the operation of a public utility," and second that the acquisition is in "the public interest or for the protection of consumers or investors." The Court agreed with the Commission that Michigan's acquisition was not functionally related. In so holding the Court gave weight to the Supreme Court dictum in North American[2] and adopted the Commission's strict interpretation of Section 11(b)(1):

> "The Commission in construing [Section 11(b)(1)] has adopted what has been referred to as the "functional relationship" test in order to determine whether the retention of particular business is permissible under the Act. To pass this test, the holding company or its subsidiary must clear two hurdles. First, the company must show that its "other business" is "reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system." Once a company has cleared this hurdle, the Commission then looks to see whether the second sentence of Section 11(b)(1) is adhered to, i.e., whether the retention of the "other business" is "necessary or appropriate in the public interest." . . . We think that prior judicial decisions, the principles of statutory construction, and the legislative history call for adoption of the Commission's interpretation "[3]

1. *Michigan Consolidated Gas Co. v. SEC*, 444 F.2d 913 (D.C. Cir. 1971) [Hereinafter referred to as "*Michigan*"]

2. *North American Co. v. SEC*, 327 U.S. 686 (1946), at 697

3. *Michigan*, note 1, supra, at 916 (citations omitted)

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IV. *Cogeneration is Reasonably Incidental or Economically Necessary or Appropriate to the Operations of Consolidated's Integrated Public Utility System*

a) *The Effect of the Energy Crisis on Consolidated's Industrial Market.* Consolidated has lost 20% of its industrial gas load within the past two years and is in jeopardy of losing substantially more of this market within the next few years. This is a serious threat to Consolidated's economic well being and to its future ability, not only to continue providing natural gas at reasonable cost to all its customers — industrial, commercial and residental — but also to continue providing a reasonable return to its investors. It is imperative that Consolidated do all that it feasibly can to offset, slow, and hopefully halt, this steep loss of its industrial sales. A further reduction of industrial sales will, without other sales, result in the fixed costs of Consolidated's gas delivery system to be spread over a smaller amount of product sold, thereby causing an increase in natural gas costs to Consolidated's consumers and eventually to a decrease in profits for its investors. By partially replacing Consolidated's lost industrial gas load, or retaining portions of existing load otherwise lost, cogeneration gas sales will help preserve the economic well-being of its operating utilities.[4]

In recent sworn testimony in a rate proceeding before FERC,[5] Ralbern H. Murray, President of Consolidated Gas Supply Corporation, discussed, among other things, the serious loss of industrial gas load suffered by the Consolidated System as a result of the energy crisis. The following points are brought out by his testimony:

1.) The recent recession has had a profound impact on industrial activity in Consolidated's market areas. Consolidated's 1981 industrial sales were about 20% below those for 1979 and 25% below those for 1974, our peak year. The downturn in our industrial sales is not expected to rebound rapidly. This is because of the ongoing effects of energy conservation efforts launched by industry during the gas shortage of the 70's, the continuing rise of energy prices, and the expected future regulatory strictures on the sale of industrial gas resulting from the 1978 National Energy Act.

2.) Permanent plant closings, occurring or announced in the last five years, have removed from our market some 33 Bcf of annual sales. To make up this loss would require our adding 273,000 residental customers at present consumption rates, an improbable number for our service area where our affiliates typically add somewhat less than 10,000 net residental and commercial customers a year.

3.) Our industrial market also affects our residental and commercial sales because they are ultimately tied to the economic well-being of our service area. In our residental and commercial market we must run as fast as we can merely to offset the sales lost in these markets resulting from conservation.

4.) Much of our service area has been declared a non-attainment area under the Clean Air Act for both particulate matter and sulfur dioxide. This has constrained the number of plant expansions and new plants in our area and has materially altered energy use patterns. Since 1979 new plants or plant expansions in our service area are using 32% less gas than similarly new and expanded plants required during the five year period ending 1969. We believe this decline is related to the fact that new and expanded plants are not the energy-intensive type characteristic of the past and due to the non-attainment status of much of our service area.

5.) Conservation is another recent change affecting our industrial market. Our own 1980 market survey disclosed that 85% of our industrial respondents have made and/or plan to make changes in their heat processing operations to save energy. Also, in nine cases out of ten, our customers said they were directing these conservation efforts primarily toward saving natural gas.

6.) The gas supply shortages of 1976-78 and the uncertainties as to the ultimate scope of regulations flowing from the National Energy Act to re-

4. A market assessment performed for the Gas Research Institute, portions of which are attached as Appendix 1, projects that cogeneration will increase both industrial and commercial gas sales by over 360,000 MMCF annually by 1990. A DOE study titled "Industrial Cogeneration Potential (1980-2000)" is also included in this Appendix 1.

5. Filed in FERC Docket No. RP82-115 as part of Statement P on July 15, 1982, and attached as Appendix 2.

strict the sale of industrial gas have attracted our industrial customers to electrical equipment or to oil-fired systems which can be operated interchangeably with existing gas burners. They have gone to dual fuel systems to reduce their dependence upon their gas suppliers and to be able to respond advantageously to energy price changes. We estimate that our industrial customers today can almost overnight convert 40% of our natural gas load to oil. In 1975, this figure would have been only about 20%. It is estimated that Consolidated could lose approximately 60 Bcf in annual sales if natural gas sells at a 10% premium over No. 6 fuel oil.

7.) Technological changes are also adversely affecting our industrial sales. The current limitations on the sale of industrial gas and the rapidly increasing contribution of energy costs to total manufacturing costs, have encouraged industrial electric equipment manufacturers to develop a new generation of equipment. Data compiled by the Industrial Heating Equipment Association show an ominous trend. In 1970, electric fuel-fired processing equipment sales comprised 20% of the market while gas fuel-fired equipment garnered the remaining 80%. By 1980, however, electric equipment sales climbed to 35% for an increase in market share of 75% in just ten years. The expected surge in needed industrial capital investment in the early 80's may well lead to a much wider use of improved competitive equipment, seriously threatening a further erosion of our industrial sales.

8.) The final recent change affecting our industrial marketing of natural gas was wrought by the passage of the National Energy Act of 1978. Each of the five Acts included within the National Energy Act, in different ways, restrict the future markets for natural gas.

The key and unavoidable inference to be drawn from Mr. Murray's testimony is that Consolidated must necessarily do everything within its power merely to maintain the current level of its industrial sales, already substantially reduced from the levels obtained during the years immediately preceding the crisis.[6]

b) *Functional Relationships.* One important reason industry is turning to energy sources other than natural gas is its relative high cost. Cogeneration offers Consolidated a way to help industry make more efficient use of natural gas and thus reduce its overall cost of energy. This, in turn, helps Consolidated maintain its industrial gas load. A gas-fired facility produces steam and uses the waste heat resulting therefrom to generate electricity. The steam would be sold to Cogent's industrial customer and the byproduct electricity sold to a local electric utility. The cost of steam sold to Cogent's industrial customer would be reduced by its agreed-upon share of the net revenues derived from Cogent's sale of electricity to the local utility. Thus, the steam requirements of the industrial customers would be provided at lower cost by Cogent than they would if the customer continued directly to produce its own steam from natural gas in a conventional boiler. Therefore, gas-fired cogeneration may be looked upon as a conduit through which the ultimate fuel value of natural gas is enhanced. Such enhancement not only may lead to greater natural gas sales but also may importantly conserve energy.

The reduction in overall energy cost due to cogeneration is, we believe, a significant factor in Company "A's" decision to expand its New York plant, which, if carried through, will result in increased gas sales for Consolidated from 1.4 Bcf to 3.1 Bcf annually.

The strong need for Consolidated's direct involvement in cogeneration as well as that of other gas utilities becomes apparent when it is realized that the government incentives to encourage cogeneration, as hereinafter discussed, have fallen short of gaining any significant support from non-regulated industries and electric utilities. This lack of support is attributable, depending on the company involved, to one or more of the following factors:

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6. The business news has recently recognized the difficult marketing problems currently troubling natural gas pipelines. Attached as Appendix 8 is a copy of a recent *Business Week* article on the subject, which accurately assesses the pipeline industry as a whole. Certain inaccuracies in the article as to Consolidated are explained in the Chairman's letter to *Business Week*, also attached.

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Fear of Regulation — Non-regulated industry is greatly concerned about being subjected to federal and/or state utility regulation to the extent that it would manufacture electricity and sell the excess.

Uncertainty as to the receptivity of the market for electricity — In particular, while the attitude of electric utilities is positive in a few cases, in most cases it is at least cautious, and in many instances overtly hostile. Many electrics fear the loss of their industrial base load, are concerned about the dispersion of generation to sources outside their control and focus on the cost to them of cogenerated power and the relative sharing of that cost between the cogenerator, the utility and the ultimate customer. Many utilities, though willing to negotiate with potential cogenerators, are prepared to do so only on the basis of buying this excess power inexpensively.

The capital requirements of cogeneration — It has been calculated that the displacement by cogeneration of 10% of today's industrial electric usage would require $15-$30 billion of capital, depending on the methods employed. In the modern era, capital, like energy, has become more costly. Electric utilities operate under a difficult regulatory structure which makes the raising of their large capital requirements a constant crisis. Industrial companies, though they are perhaps not as pressed as utilities in this respect, generally have higher hurdle rates for investment, less receptivity to debt leverage and shorter pay back periods, all of which tend to militate against investment in cogeneration facilities. For industrial companies, cogeneration requires far higher capital investments than its alternative of no cogeneration. For example, the capital investment of $25 million for Company "A's" cogeneration system would be twenty times higher than the cost to Company "A" of installing a conventional gas boiler. Thus, "do-it-yourself" cogeneration carries with it a large, up-front capital penalty.[7]

Consequently, the potential benefit cogeneration holds out to the gas industry with respect to increasing demand for its only product may well not be realized unless the gas industry itself builds and operates cogeneration facilities.

There is a natural relationship between cogeneration and the natural gas industry stemming from such industry's familiarity with government regulation, its operational experience in providing energy to industry, its relatively modest capital requirements and its acceptance of conservative investment returns. The Congressional encouragement of gas industry participation in cogeneration is evidenced by its exclusion of certain natural gas use restrictions[8] and incremental pricing requirements[9] from cogeneration applications.

In cogenerating, CNG Energy will be producing electricity as a byproduct as a means of reducing the cost of its steam sales and thereby the cost of its customer's ultimate source of energy, natural gas. Pursuant to Section 210(e) of PURPA, FERC has prescribed[10] that a qualifying cogeneration facility shall not be considered an "electric utility company" as defined in Section 2(a)(3) of the Public Utility Holding Company Act. As a response to the energy crisis, registered electric holding companies[11] are exploring for, and producing natural gas, in order to reduce their cost of generating electricity. We are simply doing the reverse, producing electricity to reduce the ultimate cost of natural gas to our industrial and commercial customers and indirectly to all our customers. There are distinctions but broadly viewed, in our judgment, it would border upon discrimination to regard such activity as "functionally related" in the one case but not in the other.

Ironically, the more successful the conservation of energy, the more concerned energy producers and sellers such as Consolidated need to become with retention of their market share

7. "The Capital Requirements of Cogeneration," prepared by Consolidated and attached as Appendix 4, explains why a Cogent type cogeneration project is far more feasible than one attempted directly by an industrial company. This Appendix also includes a *Harvard Business Review* article titled "Capital Investment to Save Energy."

8. Section 312(c) of the Powerplant and Industrial Fuel Use Act of 1978.

9. Section 206 of The Natural Gas Policy Act of 1978.

10. 18 CFR 292.602

11. Middle South Utilities; New England Electric System

From this standpoint, gas-fired cogeneration provides a unique opportunity for Consolidated to contribute to the national conservation policy while at the same time protecting, and perhaps even increasing, its share of either a reduced energy market or a market that is growing less rapidly due to increased conservation measures.

V. *Cogeneration is not only Necessary and Appropriate in the Public Interest but also for the Protection of Consolidated's Investors and Consumers*

a) *Public Interest.* President Carter in an address to a Joint Session of Congress on April 20, 1977 stated that if the American people respond to the energy crisis as "the moral equivalent of war, then the effort will protect our jobs, our environment, our national independence, our standard of living, and also protect our future." A year and a half later after weighing the testimony of hundreds of qualified witnesses, Congress, began enacting into law six statutes dealing with our national energy need.[12] These are the following:

Title	Public Law No.
Public Utility Regulatory Policies Act of 1979 ("PURPA")	95-617
Energy Tax Act of 1978	95-618
National Energy Conservation Policy Act ("NECPA")	95-619
Powerplant and Industrial Fuel Use Act of 1978 ("FUA")	95-620
National Gas Policy Act of 1978 ("NGPA")	95-621
Energy Security Act ("ESA")	96-294

These statutes form a broad spectrum of Federal programs designed to address the national security and national economy concerns arising from the energy crisis. They deal with regulating utilities and encouraging cogeneration and small power production facilities as in PURPA; allowing favorable energy tax credits as in the Energy Tax Act of 1978; mandating energy conservation programs for residences, schools, hospitals, and governmental buildings as in NECPA; restricting the use of petroleum and natural gas by electric powerplants and major fuel-burning installations as in FUA; pricing natural gas to encourage greater exploration and production as in the NGPA; and promoting alternate fuel sources as in ESA.

Currently, in view of the reduction in oil and gas consumption which the nation is now experiencing, accompanied by a concurrent decrease in oil imports, it may seem that the vigorous Congressional response to the energy crisis may well have eliminated the crisis. This is not so. Recent studies confirm that reducing dependence on imported oil will continue to be the principal concern and goal of United States energy policy for many years to come.[13]

The importance of cogeneration to national energy policy is reflected in a Senate Report,[14] authored by the Energy and Natural Resources Committee, describing cogeneration as one of the most promising means of reducing our energy consumption on a large scale. Because of

12. With respect to the legislative history of this Congressional activity, we recommend portions of two Congressional reports: Part II of House Report (Energy Committee) No. 95-543 on H.R. 8444 (July 27, 1977), and Part I of House Report (Interstate and Foreign Commerce Committee) No. 95-496 — Part IV on H.R. 6831 (July 19, 1977), both of which are attached as Appendix 5.

13. Chapter 7, "Energy in America's Future: The Difficult Transition" written by Joseph A. Yager and included in "Energy Policy in Perspective", The Brookings Institution, 1981, appended as Appendix 6.

14. At page 48 of Senate Report No. 95-361 on S.977, July 25, 1977.

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its efficiency,[15] the Committee believed that cogeneration could save up to two million barrels of oil per day under an extensive cogeneration program. The Committee compared West Germany's cogeneration of 28% of its electricity with the 4% similarly produced in the United States. Furthermore, Section 2 of PURPA makes plain Congress's specific interest in conserving our limited sources of fuel through the more efficient production of electric energy. The protection of public health, safety and welfare, and the preservation of national security is stated therein as requiring a program to provide increased conservation of electric energy.

Congress has attempted to make cogeneration an important energy alternative for American industry through the National Energy Act:

Cooperation of Electric Utilities Required by PURPA

— Electric utilities are required to buy any electric power offered by cogeneration facilities at a rate that is just and reasonable to electric consumers and non-discriminatory against cogenerators, which has been deemed by FERC by regulation to be a rate at "full avoided cost" (Section 210).

— Electric utilities are required to sell electric power to cogenerators at non-discriminatory rates. (Section 210)

— Electric utilities are required to provide supplemental power, back-up power, maintenance power, and interruptible power. (Section 210)

— Electric utilities are required to interconnect qualifying facilities with the power line grid. (Section 202)

— Electric utilities are required to transmit electricity produced by a qualifying facility to any other electric utility. The receiving utility would then be subject to all of the above requirements. (Section 203)

Incremental Pricing Exemption Under NGPA and PURPA

— Cogeneration facilities qualifying for 18 CFR Part 292, Subpart C benefits or meeting efficiency standards and other standards that differ from qualification under Subpart B will be exempt from incremental pricing.

— Cogeneration facilities producing useful energy other than electricity sequentially with mechanical energy, are also eligible for an exemption from incremental pricing.

Utility Regulation Exemptions under PURPA

— A qualifying cogeneration facility (generally consistent with Subpart B qualification) is exempted from most provisions of the Federal Power Act. (Section 210(e))

— FERC granted power to exempt a qualifying cogeneration facility from the provisions of the Public Utility Holding Company Act. (Section 210 (e))

— FERC granted power to exempt a qualifying cogeneration facility from all state laws relating to rates and financial and organization structure, except as provided in Subpart C of PURPA. (Section 210(e))

Energy Tax Credit

— Under certain conditions, most notably a limitation of gas use to 20% of the input fuel over a calendar year, a tax credit of up to 10% of the cost of purchasing and installing cogeneration equipment but not peripheral equipment, may be taken.

Fuel Use Act Exemption

— A permanent exemption from the petroleum and natural gas restrictions of the FUA will be granted to a cogeneration facility if it can be demonstrated that the economies and other benefits of such cogeneration are otherwise unobtainable. (Section 312(c))

It is the clear, unambiguous policy of the United States to conserve energy. Such policy furthers the public interest by strengthening the national economy and promoting greater national security. The United States Congress, as earlier demonstrated, has issued an unequivocal directive to American industry to conserve the use of unrenewable sources of energy. Cogeneration is obviously deemed important by Congress as a means of achieving such conservation. Consolidated, through its proposed financing of CNG Energy Company relative to cogeneration, will be furthering this national energy policy and thereby serve the "public interest."

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15. The average centralized electric power plant delivers only about one-third of the energy contained in its primary fuel. In contrast, a cogenerator typically converts up to 80% of its fuel into useful energy.

b) *Investors and Consumers.* Consolidated is confident that its proposed cogeneration involvement will benefit its investors by making its stock more attractive, indirectly benefit its consumers by lowering the cost of its financing and serve its investors, consumers and the public by contributing to the health of various regional economies in its operating area. Less expensive energy will tend to make regional industry more competitive in national and international markets, which, in turn, should improve the employment outlook of the communities served by Consolidated, at the moment suffering from among the highest unemployment rates in the nation.

Clearly, cogeneration cannot reasonably be viewed as a "non-utility speculative venture." The extent to which Congress has encouraged investment in cogeneration should alleviate any concern in this regard. Cogeneration is an old, well-established process accorded a rebirth as a natural response to the energy crisis and the resulting high cost of energy. Moreover, it is regulated (although far less severely than under traditional state utility regulation) as a consequence of FERC's requirement that the tariff charged for electricity generated by qualifying facilities not exceed "avoided cost". Finally, any concern about speculation appears misplaced when one considers the many areas of Consolidated's expertise and experience which are so readily transferable to cogeneration.

For example, in the operation of its transmission system, Consolidated operates and maintains gas turbine equipment as the power source for natural gas pipeline compression. Gas turbines are at the center of many cogeneration systems. Also, Consolidated's gas marketing efforts have made it aware of customer requirements, end-user equipment needs available in the marketplace, and energy management and economics. In addition, Consolidated brings to this re-discovered industry experience in managing and financing major construction projects. Consolidated System companies routinely carry out construction projections of the size contemplated here.

Operating gas and electrical equipment, securing environmental permits, negotiating electric sales contracts, and keeping an eye on the fuel market for the best energy buy are tasks that many industries are not equipped to handle. Conversely, the acquisition and assurance of long-term energy supplies are the life-blood of the Cogent partners and each routinely navigates the maze of project planning and the energy regulatory environment.

We have noted that the Division helped open the door for the subsidiaries of two exempt gas holding companies to enter the cogeneration field.[16] Evidently, the Division agrees that cogeneration is not an unduly speculative activity for the gas industry.

VI. *Clear Call for a Fresh Re-examination of "Other Business" Standards*

We are convinced that under the strictest standards a "functional relationship" straightforwardly exists between Consolidated's proposed cogeneration involvement and its utility operations. Nonetheless, we recognize that our application-declaration represents the first occasion the Division has pondered the connection between the two. In approaching this initial analysis, we urge the Division to look upon the "other business" clauses as sufficiently adaptive to allow Consolidated to help forward the Government energy program so important to our national security and economy and to serve the present-day needs, so vastly altered by the energy crisis, of its investors and consumers, and the public.

Michigan was decided in 1971 preceding the enormous energy and economic shocks of the subsequent seventies and eighties. The Department of Energy was yet to be formed, The Natural Energy Act of 1978 yet to be conceived, and OPEC was yet to impose its first boycott. It was a time when the supply of and demand for natural gas were relatively stable and normally in line with prior years and when natural gas could still be purchased at bargain prices. The whistle on the predicted short duration of our nation's proved gas reserves had yet to be loudly blown. Natural gas was not being severely curtailed, allocated or appreciably conserved in 1971 nor was its use being restricted in any way. The

16. Letter from Aaron Levy to Robert R. Nordhaus, Esq., General Counsel of FERC, dated June 6, 1980.

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yearly financial needs of public utility holding companies were still obtainable at relatively modest cost. Double digit inflation and interest rates were inconceivable. (These above-recited, post-1971 jolts are collectively referred to in this letter as the "energy crisis.")

Thus, the Division of Corporate Regulation today is returning to the "other business" clauses of Section 11 in a far different energy and economic setting than prevailed in 1971 during its *Michigan* deliberations. As the Division does so, we recommended it to a law review analysis[17] of *Michigan* soon after it was decided. This analysis suggests that a consistent, yet unarticulated, "other business" standard evolves from a close reading of the Court and Commission decisions theretofore interpreting Section 11(b)(1). This purportedly existing but unexpressed standard simply postulates that if there are no substantial benefits either to the public, investors or consumers, the relationship requirement should be stringently applied; if, on the other hand, great benefits will accrue to any of these groups as a result of the proposed acquisition, the relationship requirement should be relaxed to something less than the "functional relationship" standard. The *Columbia Law Review* comment expands upon this concept:

> Although the majority declined to follow them (or did not bother to distinguish them), most of the contradictory precedents are easily distinguished and can be made to fit, along with Michigan I, into a new and consistent rule. By considering the applicable considerations to be twofold — one being concerned with the necessary relationship ("reasonably incidental, or economically necessary or appropriate") and the other being concerned with the benefit to one of the three protected groups ("appropriate in the public interest or for the protection of investors or consumers") — this new test would require that these two considerations combined, along with necessary minimums for each, form the basis for the applicable standard. This is not intended to be a mere restatement of the enlargement theory that has been advocated for the interpretation of the second "other business" clause of section 11(b)(1): here the standards under both of the "other business" clauses would still have to be met. Rather what is being suggested is that if there are no substantial benefits to any of the interested groups, the relationship requirement should be stringently applied; *if, on the other hand, great benefits will accrue to any of these groups as a result of the proposed acquisition, the relationship requirement should be relaxed to something less than the "functional relationship" standard.* None of the precedent cases in which the Commission required an operating or functional relationship involved substantial benefits to any group; consequently, a strict relationship requirement was properly imposed in those cases. But in Michigan I, where there was the promise of great public benefit, the relationship standard was properly relaxed to a requirement that the business be merely "related." True, under this approach the scope of the public interest that the Commission's consideration should encompass remains undefined. Nonetheless, whatever definition might ultimately be established, this suggested rule would provide that, the more pressing the public interest involved, the less strictly would the relationship requirement be applied.[18] (Emphasis added)

The Circuit Court precedents are consistent with this tacit rule. In *North American*[19] the utility made no effort to dispute the Commission's inability to find a functional relationship between the utility's operations and three non-utility companies. On the record before the Court, it was "not disputed that the three other businesses are unrelated to the operations of the St. Louis system." Without any offer of proof by the utility, we can only presume that there was no relationship whatsoever between the two. The D.C. Circuit in *Philadelphia Company*[20] in requiring divestment, based its decision not only on the lack of an operating relationship between Philadelphia's utility functions and its transportation business but also on the fact that the Commission

17. "Non-Utility Acquisition under the Public Utility Holding Company Act", 71 *Columbia Law Review* 434 (1971) (citations omitted), attached as Appendix 7.

18. Id. at 445

19. *North American Co. v. SEC*, 133 F 2d 148 (2nd Cir. 1943), at 153

20. *Philadelphia Co. v. SEC*, 177 F 2d 720 (D.C. Cir. 1949), at 726

had found retention of such other business would not serve the public interest or protect Philadelphia's investors or consumers. Both the Third Circuit and Fifth Circuit in deciding, respectively, *United Gas*[21] and *Arkansas Natural Gas*[22] apparently would have permitted the retention of the other businesses involved in these cases without the establishment of a clear functional relationship, had the utilities been able to demonstrate that their retention would have benefitted the public interest or the utilities' investors or consumers. The D.C. Circuit in *Engineers Public Service*[23] prior to its *Philadelphia Company* decision, permitted Engineers to continue its gas appliance merchandizing, jobbing, and transportation activities solely on the basis that their retention served the interests of Engineer's investors and consumers. Finally, it is noteworthy that the U.S. Supreme Court, interpreting Section 11(b)(1) by way of dicta, felt that "other holdings may be retained only if their retention is related to the operations of the retained utility properties."[24] This is by no means mandating a strict "functional relationship" requirement.

We are encouraged by recent SEC actions suggesting that the Division is already leaning towards this unexpressed "other business" standard. Permitting a registered holding company under Rule 16 to enter into a 50/50 joint venture for the purpose of such activities as oil and gas exploration and coal gasification without the venture itself becoming subject to the Act represents, we feel, a loosening of the rigidity reflected by *Michigan* II. Other examples are the permission granted New England Electric to operate coal bearing ships and charge for the service at more than customary "cost of service" and the recent SEC authorization permitting The Southern Company and American Electric Power to form consulting subsidiaries providing electrical engineering services.

VII. *Alternate Approach — Section 9(c)(3)*

In view of the serious national interests involved, the Division may find it an appropriate exercise of its discretion to exempt Consolidated's application declaration from the Section 11 standards by permitting it under Section 9(c)(3). The Division could not find a functional relationship in either *Michigan* I or *Michigan* II, yet believed that the exceptional circumstances surrounding Michigan Consolidated's proposed acquisition warranted its approval. These circumstances were that Michigan Consolidated's proposal entailed a relatively small investment ($3.5 million in *Michigan* I and $6.5 million in *Michigan* II) in relation to its total net worth; that it was a response to important adverse developments in a major gas service area of the company and was designed to remedy their economic and operating consequences; that it was part of a Federal program under the National Housing Act designed to assist private industry in providing housing for low and moderate income facilities and displaced persons; and that in the carrying out of the project, Michigan Consolidated would be subject to an overriding system of regulation.

To solve its "functional relationship" dilemma, the Division turned to Section 9(c)(3) of the Act asserting that the Michigan Consolidated acquisition could be approved as being "appropriate in the ordinary course of business . . . and as not detrimental to the public interest or the interest of investors or consumers". The Division regarded Section 9(c)(3) as totally free of the constrictions of Section 11(b)(1).

While the Commission in *Michigan II* and the Circuit Court for the District of Columbia denied Section 9(c)(3)'s applicability to Michigan Consolidated's proposed acquisition, the American Law Institute virtually adopted the Division's advocated solution to *Michigan* in the proposed Federal Securities Code:[25]

> (e) The Commission, by rule or order, may exempt from Section 1505 (a)(1)(A) [9(a)(1) of the Act] an acquisition of a security, or any other interest in the business of a company, other than a utility company or holding company, if the acquisition is for a

21. *United Gas Improvement Co. v. SEC*, 138 F 2nd 1010 (2nd Cir. 1943), at 1021
22. *Arkansas Natural Gas Corp. v. SEC*, 164 F 2nd 597 (5th Cir. 1946), at 599
23. *Engineers Public Service Co. v. SEC*, 138 F 2nd 936 (D.C. Cir. 1943), at 947-948
24. *North American Co. v. SEC*, 327 U.S. 686 (1946), at 697.
25. Section 1505(e)

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purpose that promotes an important national interest recognized by the Congress.

In view of the fact that the Commission is supporting the enactment of the Code, it would appear that a re-examination by the Commission of Section 9(c)(3) in today's legal, economic and energy setting, would find it firmly standing behind the view earlier urged upon it by the Division in *Michigan*. This is all the more apparent when Consolidated's proposed acquisition is compared with that of Michigan Consolidated's in 1970: (i) The national security and national economy concerns interwined with Consolidated's proposal are a serious public issue as was urban housing development in the early seventies; (ii) cogeneration is directly related to energy while urban housing clearly is not; (iii) Michigan Consolidated had 100% control of its proposed urban housing venture while Consolidated through CNG Energy will acquire only a 50% interest in Cogent, its cogeneration vehicle; and finally, (iv) Consolidated's gas marketing problems have been shown to be immediate and urgent whereas Michigan Consolidated's were surmised to be a potential future problem.

We feel that cogeneration offers the Consolidated System a rare and much needed opportunity to lighten the severity of its gas marketing problems. This explains why we were somewhat deliberate in responding to your request. We thank you for your attention to this letter.

[*APPENDICES*]

Appendix

1. "Market Study Performed for GRI" together with a study by the Department of Energy entitled "Industrial Cogeneration Potential (1980-2000)" and as published in the March/April 1982 issue of *Cogeneration World*.

2. FERC Testimony of Ralbern H. Murray with exhibits submitted therewith.

3. "Gas Pipeliners," *Business Week:* August 2, 1982, page 44, together with correcting letter from G. J. Tankersley, dated July 27, 1982, to *Business Week*.

4. "The Capital Requirements of Cogeneration" prepared by Consolidated, together with article from March-April 1978 issue of *Harvard Business Review* titled "Capital Investment to Saving Energy."

5. Part II of House Report (Energy Committee) No. 95-543 on H.R. 8444 (July 27, 1977) together with Part I of House Report (Interstate and Foreign Commerce Committee) No. 95-496-Part IV on H.R. 6831 (July 19, 1977)

6. Chapter 7, "Energy in America's Future: The Difficult Transition" written by Joseph A. Yager and included in *Energy Policy in Perspective*, The Brooking Institution, 1981.

7. "Non-Utility Acquisition under the Public Utility Holding Company Act," 71 *Columbia Law Review* 434 (1971).

[*SEC Staff Reply*]

This is in response to your letter of August 12, 1982, relating to a proposal by CNG Energy Company ("CNG Energy"), a non-utility subsidiary of Consolidated Natural Gas Company ("Consolidated"), a registered holding company, to engage in designing, constructing, owning and operating cogeneration facilities that would be qualifying facilities under Section 201 of the Public Utility Regulatory Policies Act of 1978 ("PURPA"). Aspects of the proposal were first mentioned in the Form U-1 filed on November 16, 1981 (File No. 70-6680), by Consolidated and CNG Cogeneration Company, the predecessor to CNG Energy, but subsequent amendments to the filing deleted the request for Commission approval as related to cogeneration. At a meeting on June 24, 1982, with representatives of CNG Energy we discussed the legal and policy issues raised by the proposal. Additional facts were provided at the meeting, and substantial data are included with your letter of August 12.

CNG Energy proposes to acquire a 50% interest in The Cogent Energy Company ("Cogent"), an equal partnership of CNG Energy and Hydra-Co Enterprises, Inc., a wholly-owned subsidiary of Niagara Mohawk Power Corporation ("Niagara Mohawk"), an electric and gas utility company and an exempt holding company. Consolidated is an integrated gas utility holding company and it proposes through Cogent to enter into a joint venture that would be engaged in the generation of electric energy for resale to Niagara Mohawk.

Cogent has been negotiating with two potential customers (Companies "A" and "B"), both manufacturers located in New York, for cogeneration projects to be owned and operated by Cogent. The first project is for a gas-fired facility, with a capacity of 20 MW or more at an estimated total cost of $25 million. Anticipated project financing may include debt of 65% to 75%. Equity would be provided by Cogent, to which CNG Energy, as half owner, would contribute about $3 to $4 million. Cogent would sell the steam to Company A under a long-term contract, and the electricity to Niagara Mohawk under PURPA regulations. It is expected that natural gas as fuel for the facility, approximately 3.1 bcf per year, will be supplied by the local utility, Syracuse Suburban Gas Company, which is supplied by Niagara Mohawk, a major wholesale gas customer of Consolidated. The second project is for a 10 MW coal-fired facility at an estimated cost of $35 million, to be financed with debt of 65% to 75%. CNG Energy's share of Cogent's equity investment would be about $4 to $5 million. Cogent would sell the steam to Company B, and the electricity to Niagara Mohawk under PURPA regulations.

These are two projects which have been developed in detail. Consolidated has others in mind. It has discussed similar projects with other prospective cogeneration customers in all states in which the Consolidated system operates.

Under Section 9(a)(1) of the Public Utility Holding Company Act of 1935 (the "Act" or "1935 Act") the proposed acquisition by CNG Energy of its interest in Cogent is subject to Commission approval under the standards of Section 10, of which subsection (c) is pertinent here. Paragraph (1) thereof provides that we not approve an acquisition that is "detrimental to the carrying out of the provisions of section 11." Under paragraph (2) an acquisition shall not be approved unless the Commission finds that the acquisition will "serve the public interest by tending towards the economical and efficient development of an integrated public utility system."

Section 11(b)(1) provides in general that the Commission direct a registered holding company to limit operations of its system to a single integrated public-utility system, either electric or gas, not both. Over the years the Commission has ordered registered holding companies with such combined operations to divest one or the other in order to comply with the mandate of Section 11(b)(1), and for the same reasons Section 10(c)(1) limits acquisition. Section 11(b)(1) permits a registered holding company to retain another or a non-utility business that is reasonably incidental, or economically necessary or appropriate to the operations of the integrated utility business. This is the so-called functional relationship test. Section 9(a)(1) prohibits a registered holding company, directly or indirectly, to acquire "any other interest in any business" if, as Section 10(c)(1) proscribes, the acquisition is "detrimental to section 11."

Section 2(a)(3) of the Act defines an "electric utility company" to include a company that owns or operates facilities for the generation of electric energy, and Cogent will be an electric utility company, as thus defined. Sections 201 and 210(e) of PURPA give the Federal Energy Regulatory Commission ("FERC") authority to adopt rules to exempt "qualifying" facilities for small power production and for cogeneration, in whole or in part, from the Federal Power Act, the 1935 Act, state laws and regulations "respecting the rates or respecting the financial or organizational regulation of electric utilities . . ." FERC's exemptive regulation with respect to the 1935 Act (18 CFR § 292.602(b)) provides that a qualifying facility "shall not be considered an 'electric utility company' as defined" in Section 2(a)(3) of the Act.

These exemptions were intended to encourage development of cogeneration by participating companies not subject to the 1935 Act. Without the exemption companies might become holding companies subject to registration under the Act, and, as a consequence, would be forced to comply with the Act for retention or acquisition of other businesses in which these participating companies were lawfully engaged or might want to engage. It was also meant for an exempt holding company, like Niagara Mohawk, whose acquisition of its interest in Cogent, without the exemption under PURPA, would be subject to Section 10 of the Act as prescribed by Section 9(a)(2). I sug-

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gest that FERC's exemptive regulation is limited by that overall intent and purpose. There is no place or meaning for this exemptive dispensation for a registered holding company. It gains no change in status and no immunities from the Act by or for its acquisition.

If Cogent is considered, and it should be, an electric utility company, as defined and as in fact it is, the acquisition by Consolidated, a registered holding company, of a 50% partnership interest in Cogent cannot meet the requirements of Section 10(c)(2), and Consolidated does not claim it can. Consolidated prefers a broader reading of PURPA and of FERC's exemption. It regards Cogent as engaged in a non-utility business, although its primary purpose is to produce electric energy for sale. But even this fictional transfiguration will not exclude Consolidated's acquisition from the requirements of Section 10. As I noted, Section 9(a)(1) prohibits its acquisition of an interest "in any business," if, in the words of Section 10(c)(1), it is detrimental to Section 11, which, for a non-utility business, requires that it be incidental and functionally related to the operations of the utility business of the registered system, and Cogent is not.

Consolidated states that its industrial sales have been declining and its participation in the cogeneration projects is intended to increase its gas sales. I note that one of the projects is to be a coal-fired unit and that for the next few years at least, as Consolidated states, it would not be economically feasible or profitable to limit cogeneration to gas-fired facilities. The choice of fuel for the facilities, it is fair to state, will depend on comparative costs and availability of alternative fuel sources, and that choice, I assume, will not be left to Consolidated alone but will depend on agreement with the participants that Consolidated hopes to attract. It may well be that the principal attraction to cogeneration, even for Consolidated, will not be the sale of gas but the tax and price and other advantages in the sale of the electric energy that PURPA allows for qualifying facilities.

The Commission has consistently held that the functional relationship test under Section 11(b)(1) is not met because the non-utility enterprise to be acquired purchases energy from an operating company in the registered system. *Michigan Consolidated Gas Co.*, 44 SEC 361, 365-6 (1970), is the last case in which the Commission considered this question. In that case, Michigan Consolidated, a gas utility subsidiary of a holding company then registered under the Act, proposed to organize and to acquire securities of a company that was to build low-income housing in Detroit, Michigan. It was represented that sale of gas in the city was declining and that the housing project would help to increase or regain sales of gas. The Commission held that to be not relevant or sufficient to meet the statutory or functional requirements under the Act, and the Court of Appeals affirmed, *Michigan Consolidated Gas Co. v. SEC*, 444 F.2d 913 (D.C. Cir. 1971). That decision is in full accord with prior Commission cases, *The North American Co.*, 32 SEC 169, 183 (1950); *Philadelphia Co.*, 28 SEC 35, 78 (1948); *Cities Service Power & Light Co.*, 14 SEC 28, 39 (1943). I note that in 1981 Consolidated sold 173.6 bcf to industrial customers, or 22% of total gas sales. Consolidated has not suggested that under the Act it may acquire control of any or all its industrial customers to retain or increase its gas sales to them. But Consolidated now suggests that under the same Act it may organize, acquire, own and operate an electric generating company in order to obtain another customer. Section 11(b)(1) permits no such distinction.

Consolidated apparently is suggesting that the policy of PURPA to promote cogeneration should be given substantial weight so as to modify the mandate of Section 11(b)(1). There is no reason for this sort of accommodation. Section 11(b)(1) of the Act represents Federal policy, no less than PURPA. As applied to a non-utility business, Section 11(b)(1) calls for two tests. The first is the functional relationship and the other requires a finding that the retention or acquisition is "necessary or appropriate in the public interest." The standard of public interest alone is not enough. That is the clear and explicit decision by the Court of Appeals in *Michigan Consolidated*, 444 F.2d at 916-17.

In *Michigan Consolidated*, the company had urged approval because its project for low-income housing was in harmony with Federal policy under the National Housing Act. The Court of Appeals said

that as a court it "was unwilling and unable to write the National Housing Act into the Public Utility Holding Company Act of 1935. This can only be accomplished by Congress" (444 F.2d at 918). It commended the utility for its intent and public effort, and noted that the Congress passed a new housing bill which did not include a proposed amendment to permit public utility holding companies to participate in the development of low-income housing. Noting also that the deleted amendment had the support of this Commission and of the Secretary of HUD, the court concluded with an expression of hope "that our decision today will inspire further consideration of this matter by Congress as soon as its busy schedule allows" (444 F.2d 918-19). No such amending legislation has been adopted by Congress.

FERC's exemptive regulation under PURPA is not a preemptive mandate. That exemption relates to the status of the qualifying entity under Section 2 (a)(3) of the Act. It does not affect the Commission's jurisdiction over the acquisition of an interest in Cogent by a subsidiary of Consolidated. In fact last year there was introduced a bill, H.R. 2876, 97th Cong. 1st. Sess., Section 2 of which proposed to amend Section 210(e) (1) of PURPA by expanding its exemptive provisions to include "any investment or acquisition of any other interest" in a qualifying facility. The obvious purpose of this amendment was to exclude Commission approval under Sections 9(a), 10 and 11 of acquisitions in qualifying facilities by a registered holding company or its subsidiaries. The Commission opposed this amendment, which has not been adopted.

Finally, Consolidated refers to Section 9(c)(3) which permits the Commission to exempt from Section 9(a) and hence from Section 10 an acquisition of "commercial paper and other securities" within such limitations as the Commission by rule or order may "prescribe as appropriate in the ordinary course of business" of a registered holding company or subsidiary thereof "and as not detrimental to the public interest or the interest of investors or consumers." I do not consider the acquisition proposed by Consolidated as "in the ordinary course of business." In *Michigan Consolidated*, the Commission was divided on the applicability of Section 9(c)(3), but the Court of Appeals agreed with the majority. It held that Section 9(c)(3) permits an exemption for investments of limited amounts but not acquisitions that result in control (444 F.2d at 918).

The accent in Section 9(c)(3) is on dollar and other limits, and Rules 40(a) and 48(a) are good illustrations of the kind of exemptions for which Section 9(c)(3) was intended. These rules authorize investments only, not acquisitions of control. Section 9(c)(3) specifies that the exemptions it authorizes shall be "not detrimental to the public interest or the interest of investors or consumers." In general, exemptions must be consistent with the policy of the Act, and an acquisition of Cogent, as Consolidated proposes, is contrary to Section 11(b)(1), one of the main foundations of the Act. If cogeneration under PURPA is the incentive for the claimed exemption, then I suggest that an exemption from Sections 10 and 11 is not secured under cover of Section 9(c)(3), which, as I said, is not applicable and especially when the Congress expressly considered and declined to grant that exemption in PURPA itself. Statutory, like surgical, transplants have their risks and anomalies. In Consolidated's case the difficulties are not technique but incompatibilities.

In concluding this discussion, it is not irrelevant to mention that Niagara Mohawk is a substantial utility with vast resources. Its 1981 electric revenues were $1.7 billion; natural gas revenues were $431 million. It has the financial and technical abilities to design, construct and finance the 10 MW and 20 MW units that Niagara Mohawk and Consolidated have proposed. Niagara Mohawk has limited its investment to 50% because that is its maximum limit as an electric utility, if the generating company is to be a qualifying facility under PURPA. I do not believe that, without Consolidated, Niagara Mohawk will not find a co-participant to provide the modest equity investment each is to provide. If the sale of gas is Consolidated's prime objective, it can readily arrange to serve as the supplier. Since Niagara Mohawk relies on Consolidated for gas supply, any gas-fired cogeneration developed in its territory, or in the territory of Consolidated's other customers, will provide the market for gas that Consolidated wants to secure.

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Consolidated considers its proposals for cogeneration to be important, and my opinion of course is not the last word on the subject. If Consolidated desires to press for a resolution of our differences, it should file an application for approval and a notice of filing will issue in due course. In the meantime we can develop a proper record by agreement and stipulation, avoiding, if at all possible, an evidentiary hearing. Briefs will be filed in the normal sequence on dates mutually agreeable. An initial decision will be waived, and the case will be submitted to the Commission on the basis of a stipulated record and our briefs, together with other briefs that may be filed by others who, in response to the public notice, may appear to support or oppose Consolidated's application.

Section 20(c) of the Act and applicable rules prescribe that orders shall issue only after notice and opportunity for hearing, and the procedures I have outlined are in accord with these requirements. They have been followed in *Michigan Consolidated Gas Co.*, HCAR No. 16176 (Oct. 3, 1968) and in the exemption case of *Lykes Bros., Inc.*, HCAR No. 20487 (April 6, 1978).

[¶ 77,329] United Group Agencies, Inc.

Securities and Exchange Commission, Division of Corporation Finance. July 2, 1982. (Available August 2, 1982.) On SEC Significant List of January 20, 1983. Correspondence in full text.

Securities Act—Definitions—"Security"—Contracts.—A program to market group hospitalization insurance in which a company contracts with practicing or retired medical doctors to conduct large-scale mailings in each doctor's designated geographic area would probably not involve a "security" within the meaning of Section 2(1) of the Securities Act. The SEC staff especially noted that the efforts of the participating doctors, particularly the furnishing of their personal endorsements, would be critical to the success of the marketing program.

See ¶ 1011, "Securities Act—Definitions" division, Volume 1.

[Letter of Inquiry]

Our client, United Group Agencies, Inc. ("Company") proposes to engage in a program to market group hospitalization insurance and hereby requests an interpretative or no-action letter from the Division stating its view that if the offering is made as described below, no "security" within the meaning of Section 2(1) of the Securities Act of 1933, as amended ("Act") will be involved in the transactions; or, alternately, that the staff of the Division will not recommend enforcement to the Commission if the transactions hereinafter described are not registered in compliance with Sections 5 and 6 of the Act.

The relevant facts may be summarized as follows. The Company is a licensed insurance agency, authorized in its own name, or through its affiliates, to do business in at least 47 states. A substantial part of the Company's business is the sale of group health and hospitalization insurance. The Company proposes to initiate an activity in which a non-profit corporation ("Association") will enter into a "Contract for Endorsement, Consultation and Marketing Services" ("Contract") with practicing or retired medical doctors to conduct large-scale mailings in each doctor's designated geographic area. The purpose of this no-action request is to seek your confirmation that the Contract does not involve the offer or sale of a "security" to the doctor.

The Association previously will have been organized and operated primarily for the purpose of providing its members certain services and benefits, including medical newsletters, discounts at drug stores and health spas, contributions by the Association for medical research and group hospitalization insurance. The group insurance will provide a fixed payment (for example, $50.00 per day) directly to the insured for each day he or she is admitted to a hospital. The insurance will be cumulative of any other medical insurance the insured may have, and will not be geared to the amount of the insured's actual medical or hospital bills.

Under the terms of the Contract, the doctor, acting as an independent contractor and not as an employee, will be obligated to provide the following services to the Association: